PETITION FOR WRIT OF CERTIORARI

Supreme Court, U.S.
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No. 09-163

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IN THE
Supreme Court of the United States

AMERIPRISE FINANCIAL, INC., *et al.*,
Petitioners,

v.

JOHN E. GALLUS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. §80a-35(b), imposes a "fiduciary duty with respect to the receipt of compensation" on mutual fund investment advisers. It also provides that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted." 15 U.S.C. §80a-35(b)(3). In *Jones* v. *Harris Associates L.P.*, No. 08-586, this Court granted a writ of certiorari to interpret the scope of the fiduciary duty under Section 36(b). The questions presented by this petition are:

1. Whether the Eighth Circuit properly held that liability for breach of an adviser's "fiduciary duty with respect to the receipt of compensation" may be premised on the ostensible inadequacy of the adviser's disclosures to independent directors notwithstanding any impact on the "fee itself," despite the holdings of other courts that a violation of Section 36(b) may be predicated only upon a fee that is so excessive it could not have resulted from arm's-length bargaining.

2. Whether Section 36(b)(3)'s limitation that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted" restricts recovery to damages accruing during the one year prior to the filing of the complaint.

LIST OF PARTIES AND PARTIES TO THE PROCEEDINGS BELOW

Petitioners are Ameriprise Financial, Inc. (formerly known as American Express Financial Corporation); Riversource Investments, LLC; and Ameriprise Financial Services, Inc. (formerly known as American Express Financial Advisors, Inc.). Petitioners were all defendants-appellees in the court of appeals. Respondents are John E. Gallus; Alexandria Ione Faller (also known as Alexandria Ione Griffin); and Diana J. Anderson, for the use and benefit of the RiverSource Balanced Fund (formerly known as AXP Mutual Fund); Riversource Precious Metals Fund (formerly known as AXP Precious Metals Fund); Riversource Mid Cap Growth Fund (formerly known as AXP Equity Select Fund); Riversource Small Cap Advantage Fund (formerly known as AXP Small Cap Advantage Fund); Riversource Small Cap Value Fund (formerly known as AXP Partners Small Cap Value Fund); Riversource Mid Cap Value Fund (formerly known as AXP Mid Cap Value Fund); Riversource Small Company Index Fund (formerly known as AXP Small Company Index Fund); Riversource High Yield Bond Fund (formerly known as AXP High Yield Bond Fund); and Riversource Large Cap Equity Fund (formerly known as AXP Large Cap Equity Fund, successor by merger to RiverSource New Dimensions Fund and AXP Blue Chip Advantage Fund). Respondents were all plaintiffs-appellants in the court of appeals.

CORPORATE DISCLOSURE STATEMENT

Ameriprise Financial, Inc. ("AFI") is a publicly held company under the Securities Exchange Act of 1934. There are no companies that own 10% or more of AFI's stock. The only parent corporation of RiverSource Investments, LLC is AFI. The only parent corporation of Ameriprise Financial Services, Inc. is AFI.

TABLE OF CONTENTS

	Page
Questions Presented	i
List Of Parties And Parties To The Proceedings Below	ii
Corporate Disclosure Statement	iii
Opinions Below	1
Jurisdiction	1
Statutory Provisions Involved	2
Statement Of The Case	2
I. Statutory Background	2
A. The Investment Company Act	2
B. The Growth of the Mutual Fund Industry	5
II. Proceedings Below	5
A. Ameriprise's Fees and Fee Negotiation	6
B. The District Court's Decisions	9
C. The Decision of the Court of Appeals	13
Reasons For Granting The Petition	15
I. The Central Issue In This Case And *Jones* v. *Harris Associates L.P* Is The Same	15
II. The Eighth Circuit Erred By Interpreting The One-Year Limit On Damages To Extend Beyond One Year	22
Conclusion	25
Appendix A – Court Of Appeals Opinion (April 8, 2009)	1a

TABLE OF CONTENTS—Continued

Page

Appendix B – Court Of Appeals Judgment (April 8, 2009) 18a

Appendix C – District Court Amended Memorandum Opinion and Order (July 10, 2007) 20a

Appendix D – District Court Memorandum Opinion and Order (July 27, 2006) 42a

Appendix E – District Court Order (May 30, 2006) 46a

Appendix F – Relevant Statutory Provisions 65a

Appendix G – Relevant Regulatory Materials 85a

TABLE OF AUTHORITIES

Page

CASES

Bellikoff v. *Eaton Vance Corp.*, 481 F.3d 110 (2d Cir. 2007) 17

Burks v. *Lasker*, 441 U.S. 471 (1979) 3, 4, 21

Daily Income Fund v. *Fox*, 464 U.S. 523 (1984) 3, 14, 23

Dumond v. *Mass. Fin. Servs. Co.*, No. 04-11458, 2007 WL 602589 (D. Mass. Feb. 22, 2007) 14

Galfand v. *Chestnutt Corp.*, 545 F.2d 807 (2d Cir. 1976) 3

Gartenberg v. *Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982) ..... *passim*

Green v. *Fund Asset Mgmt., L.P.*, 286 F.3d 682 (3d Cir. 2002) 17, 23

In re Franklin Mut. Funds Fee Litig., 478 F. Supp. 2d 677 (D.N.J. 2007) 23

Jones v. *Harris Assocs. L.P.*:

No. 08-586 (cert. granted Mar. 9, 2009) .... *passim*

527 F.3d 627 (7th Cir. 2008) ..... *passim*

No. 04-C-8305, 2007 WL 627640 (N.D. Ill. Feb. 27, 2007) 12, 16

Kalish v. *Franklin Advisers, Inc.*, 742 F. Supp. 1222 (S.D.N.Y. 1990) 18

Krantz v. *Prudential Invs. Fund Mgmt. LLC*, 305 F.3d 140 (3d Cir. 2002) 17

Levy v. *Alliance Capital Mgmt., L.P.*, No. 97 Civ. 4672(DC), 1998 WL 744005 (S.D.N.Y. Oct. 26, 1998) 11

TABLE OF AUTHORITIES—Continued

Page

Migdal v. *Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321 (4th Cir. 2001) 16

Tannenbaum v. *Zeller*, 552 F.2d 402 (2d Cir. 1977) 4

STATUTES

15 U.S.C. § 80a-10(a) 3

15 U.S.C. § 80a-10(b) 3

15 U.S.C. § 80a-15(a) 3

15 U.S.C. § 80a-15(a)(2) 23

15 U.S.C. § 80a-15(b) 3, 4, 6

15 U.S.C. § 80a-15(b)(1) 23

15 U.S.C. § 80a-15(c) 3, 4, 6

15 U.S.C. § 80a-35(b) ..... *passim*

15 U.S.C. § 80a-35(b)(1) 4, 20

15 U.S.C. § 80a-35(b)(2) 5

15 U.S.C. § 80a-35(b)(3) ..... *passim*

28 U.S.C. § 1254(1) 2

Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 4

REGULATORY AUTHORITY

17 C.F.R. § 270.15a-2 23

69 Fed. Reg. 39798 (June 30, 2004) 4

MISCELLANEOUS

John C. Coates & R. Glenn Hubbard, *Competition in the Mutual Fund*

TABLE OF AUTHORITIES—Continued

Page

Industry: Evidence and Implications for Policy, 33 Iowa J. Corp. L. 151 (2007) 5

Mutual Fund Amendments: Hearings on H.R. 11995, S. 2224, H.R. 13754, and H.R. 14737, 91st Cong. 203 (1969) 23

ICI Fact Book 16 (May 2008), http://www.ici.org/stats/latest/2008factbook.pdf. 5

S. Rep. No. 91-184 (1969) 3

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PETITION FOR A WRIT OF CERTIORARI

Ameriprise Financial, Inc., Riversource Investments, LLC, and Ameriprise Financial Services, Inc. respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-17a) is reported at 561 F.3d 816 (8th Cir. 2009). One of the district court's opinions (App., *infra*, 20a-41a) is reported at 497 F. Supp. 2d 974 (D. Minn. 2007); the other opinion (App., *infra*, 42a-45a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on April 8, 2009. On July 1, 2009, Justice Alito granted an extension of time within which to file the petition for a

writ of certiorari to and including August 6, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant provisions of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, are reproduced at App., *infra*, 65a-84a.

STATEMENT OF THE CASE

This case concerns the interpretation of Section 36(b) of the Investment Company Act, which provides that mutual fund investment advisers have a "fiduciary duty with respect to the receipt of compensation." On March 9, 2009, this Court granted the petition for a writ of certiorari in *Jones* v. *Harris Associates L.P.*, 08-586, to address the proper construction of that provision. Because this case raises the same issue as *Jones*, the petition should be held pending the Court's decision in *Jones* and then disposed of in light of the Court's decision in that case. In addition, this case presents the question whether Section 36(b)(3)'s limitation on damages to the "period prior to one year before the action was instituted" precludes the recovery of damages accruing after the filing of the complaint. That question too has divided the federal courts. In the event the Court does not grant the petition, vacate the judgment, and remand in light of its decision in *Jones*, it should grant the petition to resolve that issue.

I. STATUTORY BACKGROUND

A. The Investment Company Act

Congress enacted the Investment Company Act of 1940 (the "ICA"), 15 U.S.C. § 80a-1 *et seq.*, to protect mutual fund investors. A mutual fund is an investment company that pools money from multiple investors for investment in stocks, bonds, or other securities. Management of mutual funds is typically externalized. Most

mutual funds "are formed, sold, and managed" by a "separately owned and operated" investment adviser that "[s]elects the funds' investments and operate[s] their business[ ]." *Burks* v. *Lasker*, 441 U.S. 471, 481 (1979) (quoting S. Rep. No. 91-184, at 5 (1969)); see *Daily Income Fund* v. *Fox*, 464 U.S. 523, 536 (1984). An investment adviser registered under the ICA's companion statute, the Investment Advisers Act, 15 U.S.C. §80b-1 *et seq.*, professionally manages the mutual fund's portfolio, selects investments, accounts for shareholders' transactions in fund shares, provides support and other services to fund shareholders, and supervises the fund's daily operation.

The externalization of management to an investment adviser by contractual delegation poses the risk of conflicts of interest between the fund and its manager. *Burks*, 441 U.S. at 481 (citing *Galfand* v. *Chestnutt Corp.*, 545 F.2d 807, 808 (2d Cir. 1976)). The ICA accordingly requires mutual funds to be independent from their investment advisers in multiple respects. *Burks*, 441 U.S. at 482; 15 U.S.C. §§80a-10(a) to 10(b), 80a-15(a) to 15(c). The "cornerstone of the ICA's effort to control conflicts of interest within mutual funds" is the requirement of independence on the part of a fund's board. *Burks*, 441 U.S. at 482. At least 40 percent of a mutual fund's directors or trustees must be disinterested with respect to the investment adviser. 15 U.S.C. §80a-10(a). The ICA then "assigns a host of special responsibilities" to these "statutorily disinterested" board members. *Burks*, 441 U.S. at 482-83. Critically, they must "review and approve the contracts of the investment adviser." *Id.* at 483. And while all fund board members vote on the agreement between the fund and its investment adviser, the fees paid to the investment adviser can be established only by a majority of disinterested trustees. 15 U.S.C. §80a-15(c). The independent board members are thus in a

position to act—and are mandated to function—as "independent watchdogs," *Burks*, 441 U.S. at 484 (quoting *Tannenbaum* v. *Zeller*, 552 F.2d 402, 406 (2d Cir. 1977)), for the benefit of fund investors.

The ICA and SEC regulations oblige mutual fund trustees performing that "watchdog" role to request and to review extensive disclosures relating to the adviser's fees, costs, and profits. Section 15(c) of the ICA requires investment advisers to furnish, and fund directors to examine, all information "reasonably . . . necessary to evaluate the terms" of any investment advisory contract. 15 U.S.C. §80a-15(c). SEC rules require, among other things, disclosure of (a) the costs of the services the investment adviser provides to the fund, (b) the profits the investment adviser and its affiliates realize from their relationship with the fund, (c) the extent to which economies of scale are realized as the fund grows, and (d) how such economies of scale benefit investors. See 69 Fed. Reg. 39798, 39801 (June 30, 2004).

This case arises under Section 36(b) of the ICA, 15 U.S.C. §80a-35(b), which was adopted in 1970 together with other provisions intended to "strengthen further the independence" of fund boards with "stricter requirements" limiting director "interests." *Burks*, 441 U.S. at 482-83. See Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413. Section 36(b) provides that investment advisers have "a fiduciary duty with respect to the receipt of compensation" from the mutual funds they serve. 15 U.S.C. §80a-35(b). The measure also creates a private cause of action that shareholders may assert on behalf of a fund to recover damages arising from a breach of the investment adviser's duty. *Ibid.* In any such suit, proof of "personal misconduct" is not necessary, but the plaintiff has "the burden of proving a breach of fiduciary duty." 15 U.S.C. §80a-35(b)(1). The court retains discretion to accord the inde-

pendent board's approval of challenged fees such consideration "as is deemed appropriate under all the circumstances." 15 U.S.C. §80a-35(b)(2). Only "actual damages resulting from the breach of fiduciary duty" are recoverable, and they may not be awarded "for any period prior to one year before the action was instituted." 15 U.S.C. §80a-35(b)(3).

B. The Growth of the Mutual Fund Industry

Since the enactment of Section 36(b) in 1970, the mutual fund industry has experienced explosive growth and dramatically increased competition. Today, nearly 700 financial services companies compete aggressively for investors' dollars by creating fund "families" that offer an array of individual funds across multiple asset classes and investment objectives. ICI Fact Book 16 (May 2008), http://www.ici.org/pdf/2008_factbook.pdf. Those companies offer investors a choice of over 8,700 open-end mutual funds, over 660 closed-end funds, and over 600 exchange traded funds. *Id.* at 15. Multiple organizations publicly review and rate those funds' fees, costs, and performance.

Funds typically do not switch advisers. Advisers thus rarely compete for the business of funds formed by competitor "families." But advisers and the funds they form and manage compete intensely for investors' dollars on the basis of factors such as fees, performance, and service. Thus, "price competition is in fact a strong force constraining fund advisors." John C. Coates & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 Iowa J. Corp. L. 151, 153, 164, 196 (2007).

II. Proceedings Below

Petitioners (collectively "Ameriprise") are investment advisers. In 2004, respondents (collectively "Gallus") filed suit against Ameriprise on behalf of eleven current

and former funds (the "Funds") for which Ameriprise serves as the investment adviser. App., *infra*, 2a.[1] The suit alleged that Ameriprise breached its fiduciary duty with respect to the receipt of compensation from the Funds in violation of Section 36(b). App., *infra*, 2a. The complaint specifically alleged that Ameriprise charged a fee that was "so disproportionately large that it [bore] no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." Ameriprise C.A. Br. Supp. Add. 3-4. The pleading by its terms quoted and invoked the liability standard for Section 36(b) articulated in *Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982). Ameriprise C.A. Br. Supp. Add. 3-4.

A. Ameriprise's Fees and Fee Negotiation

The boards of directors of each of the Funds were at all times comprised of experienced professionals with financial and management expertise from a range of business, legal, government, and academic backgrounds. C.A. App. 65, 80. Despite the ICA requirement that at least 40% of any fund's board be disinterested, here fully 75% of the Funds' directors were independent. C.A. App. 65-66, 80-81. Each year, pursuant to Section 15(c) of the ICA, 15 U.S.C. §80a-15(c), Ameriprise delivered to the boards extensive information on a wide variety of topics in connection with their annual negotiation of the advisory contract. During the relevant time period for this action, the boards also requested and received supplemental reports from Ameriprise, including a detailed

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[1] The district court's initial scheduling order authorized the parties to conduct discovery concerning two of the eleven funds named in the suit, one of which had merged into a third fund. Pretrial Sch. Order, May 3, 2005, at 1; C.A. App. 55. The case accordingly proceeded with respect to Blue Chip Advantage Fund, New Dimensions Fund, and Large Cap Equity Fund.

report comparing the fees paid and services received by the Funds with the fees paid and services received by Ameriprise's non-mutual-fund institutional clients. C.A. App. 159, 164-65, 170-71, 257-72.

The Funds' independent directors negotiated the Funds' contracts with Ameriprise pursuant to a pricing strategy that aimed for fees "at or below the median" of fees charged by other investment advisers to comparable funds. C.A. App. 163, 253-56, 280-82. Ameriprise and the Funds' independent directors negotiated fees for investment management services, calculated as a percentage of each Fund's net assets at the end of the preceding month. C.A. App. 58-59, 73, 85, 90, 93, 98. The negotiated fee schedule for each Fund featured "break-points," *i.e.*, asset levels at which the fees declined. C.A. App. 58, 73, 85, 90, 93, 98. And the independent directors also bargained for "circuit-breakers," *i.e.*, upward or downward adjustments to fees based upon performance. The following table summarizes the investment management fees negotiated and approved by the independent directors for the three Funds at issue in this case:

<table>
<tr><th>Blue Chip Advantage Fund</th><th>New Dimensions Fund</th><th>Large Cap Equity Fund</th></tr>
<tr><td>First $250 million under mgmt:
0.540%</td><td rowspan="4">First $1 billion under mgmt:
0.600%</td><td rowspan="4">First $1 billion under mgmt:
0.600%</td></tr>
<tr><td>Next $250 million under mgmt:
0.515%</td></tr>
<tr><td>Next $250 million under mgmt:
0.490%</td></tr>
<tr><td>Next $250 million under mgmt:
0.465%</td></tr>
</table>

Next $1 billion under mgmt: 0.440%	Next $1 billion under mgmt: 0.575%	Next $1 billion under mgmt: 0.575%
Next $1 billion under mgmt: 0.410%	Next $1 billion under mgmt: 0.550%	Next $1 billion under mgmt: 0.550%
Next $3 billion under mgmt: 0.380%	Next $3 billion under mgmt: 0.525%	Next $3 billion under mgmt: 0.525%
Assets over $6 billion: 0.350%	Next $6 billion under mgmt: 0.500%	Next $6 billion under mgmt: 0.500%
	Next $12 billion under mgmt: 0.490%	Next $12 billion under mgmt: 0.490%
	Assets over $24 billion: 0.480%	Assets over $24 billion: 0.480%

See C.A. App. 58, 73, 85, 90, 93, 98. In addition, pursuant to Section 12(b) of the ICA and Rule 12b-1, the Funds paid a "12b-1 fee" for distribution and shareholder servicing. See, *e.g.*, C.A. App. 60-61, 87-88, 95-96 (reporting a 0.25% or 25 basis-point fee for Class A shares).

Each of the asset-based fees negotiated for by the independent directors was below industry medians for peer funds. C.A. App. 194-95, 283.[2] Nevertheless, the Funds' investment returns exceeded the performance of comparable funds. C.A. App. 242. During the relevant period (through December 31, 2003), the New Dimen-

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[2] In 2002 and 2003 respectively, the basic fee for the New Dimensions Fund was 0.021% and 0.121% below the median of peer group funds; Blue Chip Advantage Fund's basic fee was 0.049% and 0.071% below the median of peer group funds; and Large Cap Equity Fund's fee was 0.10% and 0.686% below the median of peer group funds.

sions Fund and the Large Cap Equity Fund each ranked in the top quartile of funds in their peer universe. C.A. App. 242. The Blue Chip Advantage Fund ranked in the second quartile of comparable funds. C.A. App. 242. The Performance Incentive Adjustment "circuit-breakers" that the independent directors negotiated also influenced fees. See C.A. App. 244. In 2002, the Blue Chip Advantage Fund's management fee was adjusted downward by 4.60% as a result of the Performance Incentive Adjustment, C.A. App. 180, and in 2003, the New Dimensions Fund's fee was reduced by 0.07% as a result of the Performance Incentive Adjustment, C.A. App. 245. Likewise, when fund performance exceeded targets, management fees were adjusted upward. See, *e.g.*, C.A. App. 180, 245 (adjusting New Dimension's fee upward by 5.61% in 2002 and adjusting Blue Chip Advantage's fee and Large Cap Equity's fee upward by 0.07% and 0.08%, respectively, in 2003).

B. The District Court's Decisions

1. Gallus filed the initial complaint in the District of Arizona on June 9, 2004. The case was transferred to the District of Minnesota, and Ameriprise moved to dismiss the complaint for failure to state a cognizable claim. Expressing "concern regarding the basis and veracity" of allegations pertaining to Ameriprise's provision of information to the board, the district court held that the complaint survived "by only the narrowest of margins," and limited discovery. Mem. Op. & Order, Mar. 7, 2005, at 7-8. The magistrate judge ordered that discovery be limited to two funds selected by Gallus. Pretrial Sch. Order, May 3, 2005, at 1.[3]

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[3] Gallus selected the New Dimensions Fund and the Large Cap Equity Fund, which was the successor by merger to the Blue Chip Advantage Fund. C.A. App. 55.

Gallus conducted extensive document and deposition discovery about fee negotiations and the resulting contracts, securing exhaustive information on Ameriprise's services, costs, profits, compensation practices, and comparative fees charged and services provided to other clients, as well as Ameriprise's disclosures to the Funds' directors. C.A. App. 100-424, 482-508, 574-611, 620-23, 665-829, 832-85, 1039-76, 1177-393. Gallus deposed Ameriprise employees, portfolio managers, accountants, finance personnel, and executives at every level, including the Chief Executive Officer and the Chief Investment Officer. See, *e.g.*, C.A. App. 518-27, 553-68, 571-72. Gallus also questioned independent directors under oath about the actual give-and-take of negotiation, the directors' information and knowledge in those negotiations, and their pricing strategy. See, *e.g.*, C.A. App. 528-52. The parties each deposed multiple experts retained on multiple subjects, including industry fees, competition, investment advisory services, and cost accounting. See, *e.g.*, C.A. App. 446-95.

In addition to the extensive array of information collected with respect to the fees negotiated for the contract year at issue in the complaint, Gallus also sought discovery with respect to performance, costs, negotiations, and charges for periods and contracts executed after the one-year damages period that the pleading by its terms challenged. On May 30, 2006, the magistrate judge declined to permit that discovery. App., *infra*, 58a-60a. "As other courts have determined, under the ICA, damages are limited to the one-year period before the filing of the action." App., *infra*, 60a. On July 27, 2006, the district court denied Gallus's objections to the Magistrate's ruling. App., *infra*, 42a-45a. "After reviewing the applicable case law," the district court "conclude[d] that, under the ICA, damages are limited to the one-year period before the filing of the action." App., *infra*, 44a.

2. On July 10, 2007, the district court granted Ameriprise's motion for summary judgment, holding that there were no material issues of disputed fact and that on the undisputed record Ameriprise had not breached its "fiduciary duty with respect to the receipt of compensation" in violation of Section 36(b). App., *infra*, 28a-38a. The court cited the "seminal case," *Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982), which Gallus's initial complaints had specifically invoked. App., *infra*, 29a; see Ameriprise C.A. Br. Supp. Add. 3-4. In *Gartenberg*, the Second Circuit held that "to violate section 36(b), an 'advisor-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining.'" App., *infra*, 29a (quoting 694 F.2d at 928). *Gartenberg* instructed district courts to consider all pertinent facts related to the alleged "excessiveness" of a fee, including such factors as: (1) the nature and quality of the services provided by the adviser to the shareholders; (2) the profitability of the mutual fund to the adviser; (3) "fall-out" benefits;[4] (4) the economies of scale realized by the adviser; (5) comparative fee structures with similar funds; and (6) the independence and conscientiousness of the independent trustees. 694 F.2d at 928-31.

Applying *Gartenberg*'s "so disproportionate" standard to the facts before it, the district court held that Gallus did not raise a material issue of fact showing that Ameriprise breached its fiduciary duty. App., *infra*, 37a-38a. The court examined each of the factors identified by

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[4] "Fall-out" benefits are those benefits other than the advisory fees that flow to the adviser or its affiliates as a result of the adviser's relationship with the fund. See *Levy* v. *Alliance Capital Mgmt., L.P.*, No. 97 Civ. 4672(DC), 1998 WL 744005, at *2 (S.D.N.Y. Oct. 26, 1998).

Gartenberg and, in each instance, found no genuine disputed issue of material fact. The district court specifically addressed Gallus's primary claim that the "comparative fee structures" Ameriprise charged to mutual funds and institutional accounts established a breach of fiduciary duty. The court observed that, in *Gartenberg* itself, the Second Circuit rejected a similar comparison. Rebuffing Gallus's assertion that "'the lower fees charged by investment advisers to large pension funds should be used as a criterion for determining fair advisory fees'" for mutual funds, the court explained that the "nature and extent of the services required by each type of fund was different." App., *infra*, 34a-35a (quoting *Gartenberg*, 694 F.2d at 930 n.3). Indeed, the court noted, since *Gartenberg*, multiple "courts have held that other mutual funds provide the relevant comparison for measuring fees—not non-mutual fund institutional clients." App., *infra*, 35a (citing cases).

The district court also determined that, on the record before it, Gallus had "not demonstrated that the services provided to the different types of funds are comparable." App., *infra*, 35a. To the contrary, the undisputed evidence showed that "the services provided to the Funds were different than those provided to the institutional clients," App., *infra*, 35a, thereby justifying the fee differential. Finally, quoting the district court decision in *Jones* v. *Harris Associates L.P.*, No. 04-8305, 2007 WL 627640, at *8 (N.D. Ill. Feb. 27, 2007)—which was later affirmed by the Seventh Circuit and is now under review by this Court—the district court held that, even if one compared the rates charged respectively to mutual funds and institutional clients, the comparison would not support the charge of breach of fiduciary duty: "'[E]ven assuming for the mere sake of comparison that the services [the adviser's] institutional clients received were indistinguishable from those the Funds received, the

amounts paid by different parties establish a range of prices that investors were willing to pay.'" App., *infra*, 35a.

C. The Decision of the Court of Appeals

The Eighth Circuit reversed, holding that an investment adviser could breach its "fiduciary duty with respect to the receipt of compensation" by its "conduct" during negotiations, even if that conduct did not affect the "fee itself." App., *infra*, 12a-15a.

At the outset, the court of appeals noted that the case presents a question about "the scope of the fiduciary duty imposed on advisers of mutual funds by §36(b) of the Investment Company Act of 1940" that has "created a split among our sister circuits." App., *infra*, 2a. The court of appeals also observed that this Court had granted certiorari in *Jones* v. *Harris Associates L.P.*, No. 08-586, to resolve that conflict among the circuits. App., *infra*, 11a-12a. The Eighth Circuit then rejected the approaches of every other circuit and embarked on its own interpretation of the statute.

The court first held that the district court erred by relying on the liability standard articulated by the Second Circuit in *Gartenberg*. App., *infra*, 14a. "The *Gartenberg* case," the court of appeals stated, "demonstrates one way in which a fund adviser can breach its fiduciary duty; but it is not the only way." App., *infra*, 12a. The court explained that, as it "read the plain language of §36(b)," Congress also "impose[d] on advisers a duty to be honest and transparent throughout the negotiation process." App., *infra*, 12a. According to the court of appeals, *Gartenberg* addresses the standard that applies when the challenge is to the "fee itself" and not to the adviser's conduct while bargaining. App., *infra*, 12a-13a. The Eighth Circuit said "that the proper approach is one that

looks to both the adviser's conduct during negotiation and the end result." App., *infra*, 13a.

Applying that new yardstick to the factual record, the Eighth Circuit reversed the district court's entry of summary judgment, even though Ameriprise's fees "passed muster under the *Gartenberg* standard." App., *infra*, 14a. The court held that, despite the district court's conclusion "that Ameriprise did not breach its fiduciary duty in one way (by setting a fee that was exorbitant relative to that of other advisers)," the district court nevertheless should have considered "other possible violations of §36(b)." App., *infra*, 15a. According to the Eighth Circuit, a district court evaluating a Section 36(b) claim must go beyond the sheer size of a fee, and scrutinize whether an adviser "purposefully omitted, disguised, or obfuscated information." App., *infra*, 15a.

The court of appeals also held that, under Section 36(b)(3), the damages period extends beyond the filing of the complaint. App., *infra*, 16a-17a. The text of the statute, the court observed, clearly precludes a plaintiff from seeking damages that reach *back* more than one year before the complaint was filed. App., *infra*, 16a. But the appeals court rejected the district court's conclusion that the statute also precludes damages reaching *forward* following the filing of the complaint. The court acknowledged that the lower court's decision was supported by "brief dicta" in this Court's decision in *Daily Income Fund*, 464 U.S. at 526 n.2. App., *infra*, 16a. But the court of appeals deemed the analysis in an unreported district court decision—*Dumond* v. *Massachusetts Financial Services Co.*, No. 04-11458, 2007 WL 602589 (D. Mass. Feb. 22, 2007)—more persuasive. App., *infra*, 16a-17a. It thus authorized recovery of damages for fees not yet set or even negotiated when the action was instituted—much less "received" by an adviser

subject to a "fiduciary duty with respect to the *receipt* of compensation." 15 U.S.C. 80a-§35(b) (emphasis added).

REASONS FOR GRANTING THE PETITION

This case presents the same issue as *Jones* v. *Harris Associates L.P.*, No. 08-586 (petition granted Mar. 9, 2009)—namely the scope of the "fiduciary duty with respect to the receipt of compensation" imposed on mutual fund investment advisers by Section 36(b) of the Investment Company Act of 1940. The court of appeals expressly acknowledged the identity of the issues, noting that this Court had granted review in *Jones* to resolve "a question that has created a split among our sister circuits." App., *infra*, 2a. Because this case and *Jones* present the same issue, the Court should hold the petition pending *Jones* and then dispose of it as appropriate in light of its decision in *Jones*. In the event this Court does not vacate and remand in light of *Jones*, it should grant the petition to resolve another question that has divided the courts—whether a plaintiff is limited to recovering damages for the one-year period preceding the filing of the complaint, or whether a plaintiff may also recover damages allegedly incurred after the filing of the complaint.

I. THE CENTRAL ISSUE IN THIS CASE AND *JONES* V. *HARRIS ASSOCIATES L.P.* IS THE SAME

A. There can be no dispute that this case raises precisely the question currently before the Court in *Jones* v. *Harris Associates L.P.*, No. 08-586. In *Jones*, as here, the plaintiffs filed suit under Section 36(b), asserting that the investment adviser charged excessive fees. Compare App., *infra*, 2a, with No. 08-586 Pet. App. 2a (527 F.3d at 629). In *Jones*, as here, the district court granted summary judgment to the defendants, applying the standard initially articulated in *Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982). Compare App., *infra*, 37a, with No. 08-586 Pet.

App. 27a-33a (see 527 F.3d at 629). Under that standard, there can be no breach of fiduciary duty unless an investment advisor "charge[s] a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." 694 F.2d at 928. In both cases, the courts of appeals acknowledged that other courts had followed *Gartenberg*'s approach. App., *infra*, 10a (citing cases); No. 08-586 Pet. App. 8a (527 F.3d at 632). Yet, in both cases, the courts of appeals rejected application of the Second Circuit's *Gartenberg* standard in favor of a new articulation. In *Jones*, the Seventh Circuit "disapprove[d] the *Gartenberg* approach," declaring that the statute "does not say that fees must be 'reasonable' in relation to a judicially created standard." No. 08-586 Pet. App. 8a (527 F.3d at 632). In this case, the Eighth Circuit observed that the Seventh Circuit's decision in "*Jones* highlights a flaw in the way many courts have applied *Gartenberg*." App., *infra*, 12a. *Gartenberg* "demonstrates one way in which a fund adviser can breach its fiduciary duty; but it is not the only way." App., *infra*, 12a. According to the Eighth Circuit, an investment adviser can breach its fiduciary duty "with respect to the receipt of compensation" under Section 36(b) even if the fee "passed muster" under *Gartenberg* and is not "exorbitant" in relation to what other advisers charge if the defendant's "conduct" suggests the absence of an "honest and transparent" negotiation process. App., *infra*, 12a-15a.

The decision below accordingly now represents one of at least three different constructions of Section 36(b). Some courts following *Gartenberg* have held that, contrary to the decision below, there can be no liability absent proof that the fees were excessive. See *Migdal* v. *Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321, 327 (4th Cir. 2001) ("[I]n order to determine whether a fee is

excessive for purposes of Section 36(b), a court must examine the relationship between the fees charged and the services rendered by the investment adviser." (citing *Gartenberg*, 694 F.2d at 928)); *Krantz* v. *Prudential Invs. Fund Mgmt. LLC*, 305 F.3d 140, 143 (3d Cir. 2002) (adopting Fourth Circuit rationale that dismissal was appropriate "since plaintiff failed to allege any facts indicating that the fees received were disproportionate to services rendered").[5] Some have read the Seventh Circuit's decision in *Jones* to eschew a focus on the size of the fee altogether (as improper rate regulation) and to focus instead only on whether there was trickery or deceit. See No. 08-586 Pet. App. 8a-9a (527 F.3d at 632-33). The decision below, after addressing both *Jones* and *Gartenberg* at length, App., *infra*, 9a-12a, follows a third route that purports to combine the approaches of those cases, requiring district courts to "look[] to both the adviser's conduct during negotiation" (per *Jones*) *and* "the end result" (per *Gartenberg*). App., *infra*, 13a. Which (if any) of those approaches is correct is precisely what this Court will resolve in *Jones*.

The identity of the questions presented in this case and *Jones* is underscored by the merits briefs filed in that case. The *Jones* petitioners expressly invoke the decision below as embodying their proposed construction

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[5] See also *Bellikoff* v. *Eaton Vance Corp.*, 481 F.3d 110, 118 (2d Cir. 2007) ("In order to state a claim under § 36(b), one must allege excessive fees, rather than fees that might simply be described as 'improper.'" (quoting *Gartenberg*, 694 F.2d at 928)); *Green* v. *Fund Asset Mgmt., L.P.*, 286 F.3d 682, 686 (3d Cir. 2002) (because plaintiffs alleged only situation creating potential for improper conduct rather than actual improper conduct "and because plaintiffs have not alleged any *actual damages* they or the Funds suffered as a result of any improper decision by the Funds' investment advisors, they do not have a cognizable claim under § 36(b)" (emphasis added)).

of Section 36(b). See No. 08-586 Pet. Br. 25. So too do various *amici* supporting the *Jones* petitioners. See, *e.g.*, No. 08-586 Br. N. Am. Sec. Admin. 13 (citing decision below as "a modern day articulation of the scope of the fiduciary duty under Section 36(b)"). While respondents and their *amici* have yet to file in *Jones*, it seems fair to predict that their submissions will inevitably underscore the identity of the issues presented in this case and that one.

B. This case raises the same issues as *Jones* in another, more granular, respect. The plaintiffs in both cases (indeed, represented by the same lawyers) advance as their primary claim the contention that the adviser's breach of duty could be established by a comparison between the fees charged to mutual funds and those paid by institutional clients. In *Gartenberg*, the Second Circuit rejected the claim that "the lower fees charged by investment advisers to large pension funds should be used as a criterion for determining fair advisory fees for money market funds" because the services offered to mutual funds and institutional clients (not to mention the business risks associated with each) are distinct. 694 F.2d at 930 n.3. In *Jones*, the Seventh Circuit also rejected that comparison, noting that "[d]ifferent clients call for different commitments of time," and that mutual funds can be more demanding to manage because of the need to "hold some assets in high-liquidity instruments to facilitate redemptions." No. 08-586 Pet. App. 13a (527 F.3d at 634); see also *Kalish* v. *Franklin Advisers, Inc.*, 742 F. Supp. 1222, 1237 (S.D.N.Y. 1990) ("Under the cases, to the extent that comparisons are probative at all, a mutual fund adviser-manager must be compared with members of an appropriate universe: adviser-managers of similar funds.").

In the decision below, the Eighth Circuit also focused upon the significance of the comparison. According to

the panel, "[t]he purpose of an inquiry into the fees paid by institutional, non-fiduciary clients is to determine what the investment advice is worth." App., *infra*, 14a. In that respect, the Eighth Circuit echoed *Gartenberg*'s admonition that "all of the surrounding circumstances" bearing upon a fee's propriety bear scrutiny. See *Gartenberg*, 694 F.2d at 928. But the court of appeals went on to hold that, quite apart from the comparison's effect on the mutual fund "fee itself," examination of an adviser's disclosures about the aptness of the comparison was also required to measure the adequacy of its negotiating "conduct." App., *infra*, 14a-15a. Even though the district court had held on undisputed facts that the services provided to the two types of clients were different, App. *infra*, 35a, the Eighth Circuit ruled that "one way" that an adviser could breach its fiduciary duty "with respect to the receipt of compensation" was through its conduct in disclosing those differences, even if the disclosure did not impact the "fee itself." App., *infra*, 12a, 15a.

That conclusion puts the ostensible comparison between institutional and mutual fund fees—the issue that is at the heart of the *Jones* case—at the center of this case as well. The petitioners' primary argument in *Jones* is that both the Second Circuit's decision in *Gartenberg* and the Seventh Circuit's decision in *Jones* improperly disregarded that comparison. No. 08-586 Pet. Br. 30-31. Indeed, the primacy to the petitioners of the ostensible comparison is advanced in the very question they present for review.[6] And they cite the Eighth Circuit's decision

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[6] "Whether a shareholder's claim that the fund's investment adviser breached its fiduciary duty by charging an excessive fee—*more than twice the fee it charged to funds with which it was not affiliated*—is cognizable under § 36(b), even if the shareholder does not show that the adviser misled the fund's directors who approved the fee." No. 08-586 Pet. Br. i (emphasis added).

in this case to support their contention. *Ibid.* The brief of the United States in *Jones* likewise joins the issue, urging that the comparison is proper if plaintiffs meet their burden of proving that the services are similar. No. 08-586 U.S. Br. 29-31. And *amici* in *Jones* join the issue too, again citing the decision below in this case. See, *e.g.*, No. 08-586 Br. John Bogle 24.

C. Apart from the identity of the issues in this case and those before this Court in *Jones*, the Eighth Circuit's decision cannot be sustained. Addressing the standard for determining whether there has been a breach of fiduciary duty under Section 36(b), the Eighth Circuit ruled that courts can find a breach on the basis of any flaw in the negotiating process (*i.e.*, by "looking to the adviser's conduct during negotiation") *or* if the resulting fee is sufficiently disproportionate to meet *Gartenberg*'s standard (*i.e.*, by looking at "the end result"). See p. 17, *supra*. That disjunctive standard would trigger liability for breach of fiduciary duty with "respect to the receipt of compensation" for "conduct" unrelated to "receipt" of compensation—despite the statute's express admonition that proof of "misconduct" is *not* required. 15 U.S.C. §80a-35(b)(1). And it would permit a remedy for ostensible "misconduct" even if the "fee itself" is not so large as to suggest a breach—despite the statute's explicit directive limiting remedies to "*actual damages resulting* from the breach of fiduciary duty." 15 U.S.C. §80a-35(b)(3) (emphasis added).

The consequence is that—in the Eighth Circuit at least—any conceivable, alleged flaw in the negotiating process will provoke a trial to micromanage the negotiation process in hindsight, even absent an impact on the resulting fee. That result cannot be squared with the statutory text. And it cannot be squared with the unanimous understanding that Section 36(b) is designed to provide a check on excessive fees—not to turn judges

into "super-director" second-guessers of business decisions made by independent boards. See *Burks* v. *Lasker*, 441 U.S. 471, 484 (1979).

The Eighth Circuit likewise erred in rejecting the district court's conclusion—consistent with *Jones* and *Gartenberg*—that it was inappropriate to compare the fees charged to mutual funds with those charged to institutional clients. To be sure, if an apples-to-apples comparison can be performed, charges levied upon different clients may be relevant among "all the circumstances" that a court may consider in measuring the disproportionate excessiveness for which Section 36(b) provides a remedy. App., *infra*, 14a, 35a. But the Eighth Circuit ignored the district court's conclusion that the comparison was apples-to-oranges. App., *infra*, 35a. Indeed, given the different demands and risks related to originating and operating a mutual fund for the benefit of thousands of individual, small investors under a comprehensive regulatory scheme on the one hand, and serving an institutional client's unique needs on the other, it would be rare for the comparison to be apt. That is what the Seventh Circuit's decision in *Jones* and the Second Circuit's decision in *Gartenberg* both make clear.

In this case, however, the Eighth Circuit ordered the district court to scrutinize whether the adviser "omitted, disguised or obviated information" about the comparison merely because a Gallus expert criticized an Ameriprise report to the directors suggesting that the "comparison . . . is inapt [and] the discrepancy is substantively justified." App., *infra*, 14a-15a. In short, the Eighth Circuit authorized judicial review of any after-the-fact claim that information delivered to directors about comparative fees was imperfect—including information the directors might knowledgeably determine not to consider—and irrespective of whether the disclosure impacted the "fee itself."

D. Merits aside, there can be no doubt that this Court's decision in *Jones* will inevitably require the Eighth Circuit to reconsider the decision below. This case and *Jones* concern precisely the same issue about the scope of the fiduciary duty under Section 36(b). And definitive articulation of the relevant standard will be dispositive. In this case, for example, there is no dispute that the fees were reasonable compared to similarly performing funds in the industry, App., *infra*, 4a, 35a-36a, and were the product of a robust negotiation between the adviser and unquestionably independent and informed directors, App., *infra*, 36a-37a. There is no dispute, then, that—as the district court held and the Eighth Circuit confirmed, App., *infra*, 14a, 37a—the fees charged by Ameriprise meet *Gartenberg*'s requirement that they not be so disproportionately large that they could not have resulted from arm's-length bargaining. The court of appeals was able to reverse here only by ruling that *Gartenberg* does not provide the relevant standard because the size of the "fee itself" is only "one way" in which an adviser can breach its fiduciary duty. "Conduct" independent of fee size must also be taken into account. And any "conduct" related to the comparison of institutional and mutual fund fees justifies judicial scrutiny. Because those rulings implicate precisely the issues before this Court in *Jones*, the Court's decision in *Jones* will dictate the course of any future proceedings in this case—including whether any further proceeding at all is necessary.

The Court should therefore hold this petition and dispose of it in light of its decision in *Jones*.

II. The Eighth Circuit Erred By Interpreting The One-Year Limit On Damages To Extend Beyond One Year

Section 36(b)(3) provides that "[n]o award of damages shall be recoverable for any period prior to one year be-

fore the action was instituted." Read naturally, that provision limits damages to the one year period *prior* to filing suit. The Eighth Circuit's conclusion that plaintiffs may recover damages for successive periods cannot be reconciled with the statutory text, this Court's decisions, the decisions of other courts, or common sense.

In *Daily Income Fund* v. *Fox*, 464 U.S. 523, 526 n.2 (1984), this Court observed that, under Section 36(b), "recovery is limited to actual damages for a period of one year prior to suit." *Ibid.* (citing 15 U.S.C. §80a-35(b)(3)). Court after court has come to the same conclusion. See, *e.g.*, *Green*, 295 F.3d at 743 ("[D]amages are recoverable only for the one-year period *before* the filing of the action." (emphasis added)); *In re Franklin Mut. Funds Fee Litig.*, 478 F. Supp. 2d 677, 685 (D.N.J. 2007) (holding that annual review of contracts shows that one-year limit on recovery is appropriate, and remarking that the "intent and purpose of the statute clearly limits recovery to one year"); see also *Mutual Fund Amendments: Hearings on H.R. 11995, S. 2224, H.R. 13754, and H.R. 14737*, 91st Cong. 203 (1969) ("There is . . . a one year limitation on possible damages running from the time plaintiff institutes a[n] action.") (responses of SEC Chairman Budge). That makes sense. Under the statute, investment adviser fees must be approved annually. 15 U.S.C. §§80a-15(a)(2), (b)(1); 17 C.F.R. §270.15a-2. Since every contractual fee expires within one year, "new" fiduciary breaches associated with "new" fee contracts cannot generate "actual damages" provoked from fee contracts that—by definition—have expired. It was accordingly entirely logical for Congress to require plaintiffs claiming a breach in connection with the receipt of the compensation on one-year contracts to assert their claims in one-year increments.

The Eighth Circuit's rejection of that logic is anathema to sensible litigation about fees. No complaint could

ever be complete and discovery could never close if, with each succeeding year, more damages and claims of breach were automatically incorporated by reference into the action—each with its own potential set of defenses (and its own new set of negotiations and disclosures). And rejection of that logic is equally anathema to any sensible and business-like administration of a mutual fund. No adviser or board of directors could fairly negotiate a new fee if the new contractual rates will be wrapped into existing litigation about an expired contract.

Congress clearly delineated the relevant damages period. This Court and others have fully understood that period to encompass the one-year interval that precedes the filing of the complaint. If the Court does not otherwise vacate and remand in light of its decision in *Jones*, it should grant the petition and resolve the evident conflict on this issue.

CONCLUSION

The petition for writ of certiorari should be held pending this Court's decision in *Jones* and disposed of as appropriate in light of the Court's decision in that case. In the event the Court does not otherwise vacate and remand the decision below in light of *Jones*, it should grant the petition limited to the second question presented.

Respectfully submitted.

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August 6, 2009

APPENDIX

APPENDIX A
IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 07-2945

JOHN E. GALLUS; ALEXANDRIA IONE FALLER, ALSO KNOWN AS ALEXANDRIA IONE GRIFFIN; DIANA J. ANDERSON, FOR THE USE AND BENEFIT OF THE RIVERSOURCE BALANCED FUND, FORMERLY KNOWN AS AXP MUTUAL FUND; RIVERSOURCE PRECIOUS METALS FUND, FORMERLY KNOWN AS AXP PRECIOUS METALS FUND; RIVERSOURCE MID CAP GROWTH FUND, FORMERLY KNOWN AS AXP EQUITY SELECT FUND; RIVERSOURCE SMALL CAP ADVANTAGE FUND, FORMERLY KNOWN AS AXP SMALL CAP ADVANTAGE FUND; RIVER SOURCE SMALL CAP VALUE FUND, FORMERLY KNOWN AS AXP PARTNERS SMALL CAP VALUE FUND; RIVERSOURCE MID CAP VALUE FUND, FORMERLY KNOWN AS AXP MID CAP VALUE FUND; RIVERSOURCE SMALL COMPANY INDEX FUND, FORMERLY KNOWN AS AXP SMALL COMPANY INDEX FUND; RIVERSOURCE HIGH YIELD BOND FUND, FORMERLY KNOWN AS AXP HIGH YIELD BOND FUND; RIVERSOURCE LARGE CAP EQUITY FUND, FORMERLY KNOWN AS AXP LARGE CAP EQUITY FUND, SUCCESSOR BY MERGER TO RIVERSOURCE NEW DIMENSIONS FUND AND AXP BLUE CHIP ADVANTAGE FUND,

Appellants,

v.

AMERIPRISE FINANCIAL, INC., FORMERLY KNOWN AS AMERICAN EXPRESS FINANCIAL CORPORATION; RIVERSOURCE INVESTMENTS, LLC; AMERIPRISE

FINANCIAL SERVICES, INC., FORMERLY KNOWN AS AMERICAN EXPRESS FINANCIAL ADVISORS, INC.
Appellees.

Appeal from the United States District Court
for the District of Minnesota

Submitted: April 17, 2008
Filed: April 8, 2009

Before WOLLMAN, BEAM, and RILEY, Circuit Judges.

WOLLMAN, Circuit Judge.

This appeal requires us to examine a question that has created a split among our sister circuits: the scope of the fiduciary duty imposed on advisers of mutual funds by § 36(b) of the Investment Company Act of 1940 ("ICA"), 15 U.S.C. § 80a-35(b). Because we conclude that the district court construed too narrowly the extent of the defendants' duty under § 36(b) and gave insufficient weight to contested issues of material fact, we reverse and remand for further proceedings.

The plaintiffs are shareholders of eleven mutual funds ("the Funds") that are registered investment companies under the ICA. The Funds are managed and distributed by affiliates of the defendants (collectively, "Ameriprise"). The plaintiffs filed this lawsuit on June 9, 2004, alleging that Ameriprise had breached its fiduciary duty under § 36(b) of the ICA. The district court determined that the statutory damages period was restricted to the year preceding the filing date. After allowing limited discovery, the court granted Ameriprise's motion for summary judgment on all of the plaintiffs' claims. The court

based its decision on an analysis of the factors set out in *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982). On appeal, the plaintiffs argue that the district court improperly interpreted § 36(b) and overlooked important questions of material fact.

We review *de novo* the district court's grant of summary judgment. *Ferguson v. United States*, 484 F.3d 1068, 1072 (8th Cir. 2007). "Summary judgment is proper if the 'record, when viewed in the light most favorable to the nonmoving party, shows that there is no genuine dispute of material fact and that the moving party is entitled to judgment as a matter of law.'" *Id.* (quoting *Keller v. United States*, 46 F.3d 851, 853 (8th Cir. 1995)).

1.

The fees paid to Ameriprise for advising the Funds are negotiated each year by the Funds' board of directors (the "Board"), whose primary responsibility is to represent the plaintiffs and other shareholders during the fee negotiation. According to the plaintiffs, Ameriprise breached its statutory fiduciary duty by misleading the Board during the negotiation and demanding excessive fees. The gravamen of the plaintiffs' argument can be distilled into three claims: (1) the fee negotiation was inherently flawed because it was based not on Ameriprise's costs and profits but on external factors—namely the fee agreements of similar mutual funds in the market; (2) Ameriprise provided comparable advisory services to institutional, non-fiduciary clients at substantially lower fees than it charged the plaintiffs, to whom it owed a fiduciary duty; and (3) Ameriprise misled the Board about its arrangements with non-fiduciary clients to prevent the Board from questioning the higher fees demanded by Ameriprise.

The record reflects that the negotiation between the Board and Ameriprise focused on the advisory fees

charged by peer mutual funds. Ameriprise entered the negotiation with a pricing philosophy wherein it attempted to establish fees that were "in the middle of the pack of funds with a similar size, objective and distribution model." *See* J.A. 255. The Board acquiesced in this goal of tethering fees to the industry median. According to Arne Carlson, the chairman of the Board, the negotiation was "an externally driven process." *Id.* at 529. Notwithstanding this outward focus, it is undisputed that the Board had access to a wide variety of information, including reports on the services provided to the Funds, the personnel providing those services, the investment performance of the Funds, and the profit Ameriprise derived from the Funds. Additionally, the Board requested data from a third-party industry consultant, Lipper, Inc. The Lipper data provided a comparison between Ameriprise's fees and the fees charged by a pool of other mutual funds. Both parties agree that the result of the negotiation was a fee arrangement that, broadly speaking, was comparable to the rates paid by shareholders of other mutual funds throughout the industry.

In addition to its mutual fund clients, however, Ameriprise sells its investment advice to institutional, non-fiduciary clients such as pension funds. There is significant dispute over both the relevance of any comparison between these two types of clients and the insights that such a comparison would yield. At first glance, the most striking difference between Ameriprise's mutual fund clients and its institutional clients is that the former pay an advisory fee that is substantially more—perhaps up to twice as much higher—than the latter.[1] The record is

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[1] The difference in fees mostly results from larger fee breaks for institutional accounts as the amount of assets under management increases in size.

replete with expert testimony regarding the existence and reasonableness of the discrepancy.

Professor Charles Murdock testified on behalf of the plaintiffs that the advisory service provided to the mutual funds was similar, if not identical, to the service Ameriprise provided to its institutional clients. *Id.* at 1485. Murdock explained, for example, that the Growth Spectrum III institutional account on which the plaintiffs conducted discovery was a "patterned portfolio" to the New Dimensions mutual fund—meaning that the two accounts had identical investment objectives and very similar stock holdings. The record indicates that Growth Spectrum III and New Dimensions were managed by the same individual, with the same decision to buy or sell stock shares frequently governing both accounts. *Id. at* 519-20. Murdock further explained that equalizing the fee structures of the two accounts would reduce the fees paid by mutual fund shareholders from $87.5 million to roughly $35 million, and he argued that the fee difference could not be substantively justified. *Id.* at 1489. Expert testimony for Ameriprise, however, indicated that the difference in fee was warranted by additional services provided for mutual funds, such as compliance with legal and regulatory requirements, shareholder communication, and more frequent board support. *Id.* at 1427. Ameriprise also pointed out that fee discrepancies between mutual funds and institutional accounts were common throughout the industry.

At some point during the fee negotiation, the Board became aware of the comparatively lower fees Ameriprise charged its institutional clients and requested a report explaining the similarities and differences between the two types of accounts. Even before the Board's request, there is some indication that Ameriprise knew that a fee discrepancy between institutional accounts and mutual funds might concern the Board. In

response to a *Wall Street Journal* article that discussed the industry-wide disparity in fees, an internal email noted that "this could come up in a Board meeting" and suggested that "we should have a reply, though it may or may not be convincing." *Id.* at 616.

To address the Board's concerns, Ameriprise produced a report entitled the San Diego Office Review, which compared the fee structures of mutual funds and institutional accounts. The veracity and completeness of that report is an important part of this dispute. The plaintiffs' experts claim that the report omitted or obfuscated information to make the fee discrepancy seem smaller and more justifiable than it really was. According to one of the plaintiffs' experts, "the Board did not notice the distortions, relied on the misrepresentations, and erroneously concluded exactly what the Investment Advisor mislead [sic] them into concluding: that the fees for the [mutual fund] and institutional accounts were 'in line.'" *Id.* at 1492. The plaintiffs suggest that the Board might not have ratified the fee agreement had it been given accurate information. Although Ameriprise objects to the plaintiffs' characterization of the report as inaccurate and misleading, its main argument is that the contents of the report were irrelevant. According to Ameriprise, "[a]n inadequate [negotiation] that produces an objectively reasonable fee self-evidently cannot form the basis for liability [under § 36(b)]." In effect, Ameriprise contends that an adviser cannot be liable for a breach of fiduciary duty as long as its fees are roughly in line with industry norms.

II.

Several unique features of the mutual fund industry have made it the focus of congressional regulation. *See Burks v. Lasker*, 441 U.S. 471, 480-81, 99 S. Ct. 1831, 60 L. Ed. 2d 404 (1979). Although mutual funds are technically owned by the individual shareholders who invest in

the funds, most mutual funds are created, organized, and managed by external investment advisers—an arrangement that gives the adviser a significant amount of control over the fund it serves. *Id.* at 481, 99 S. Ct. 1831. Investment advisers are compensated for their administrative service and investment advice through agreements that they negotiate with their respective funds. In the nascent stages of a fund's development, the adviser often has the ability to influence who will sit on the fund's board of directors, though this power is limited by federal securities regulations on director independence. *See* William A. Birdthistle, *Compensating Power: An Analysis of Rents and Rewards in the Mutual Fund Industry*, 80 Tul. L. Rev. 1401, 1422 (2006); *Burks*, 441 U.S. at 482-83, 99 S. Ct. 1831 (explaining the responsibilities of disinterested directors).

Experts have extensively debated the extent to which these industry characteristics interfere with robust competition and drive up fees. Some studies have concluded that inherent conflicts of interest and a lack of meaningful competition between mutual funds have led to systematic overpricing of investment advice. *See, e.g.*, Birdthistle, *supra*; John P. Freeman, Stewart L. Brown & Steve Pomerantz, *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test*, 61 Okla. L. Rev. 83 (2008); John P. Freeman & Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 Iowa J. Corp. L. 609 (2001); Donald C. Langevoort, *Private Litigation to Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty*, 83 Wash. U. L.Q. 1017 (2005); Lyman Johnson, *A Fresh Look at Director "Independence": Mutual Fund Fee Litigation and Gartenberg at Twenty-Five*, 61 Vand. L. Rev. 497 (2008); *see also* Lucian Bebchuk & Jesse Fried, *Pay Without Performance: The Unfulfilled Promise of*

Executive Compensation ix (2004) ("The absence of effective arm's-length dealing under today's system of corporate governance . . . has been the primary source of problematic compensation arrangements.").

The central component of this argument is that arm's-length bargaining does not occur between an adviser and a mutual fund because the fund cannot sever its relationship with the adviser. Critics claim that because this dynamic pervades the mutual fund industry, there is little competitive pressure to lower fees. This phenomenon may be exacerbated by the fact that the typical fee structure—which is established as a percentage of net asset value—will allow an adviser's compensation to skyrocket if the fee is not adjusted downward as a fund grows larger.

In response to these types of concerns, Congress adopted the ICA of 1940. *See Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 536-40, 104 S. Ct. 831, 78 L. Ed. 2d 645 (1983) (explaining the history of the ICA). The ICA was amended in 1970 to add several new provisions, including § 36(b), which states, in relevant part:

> For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser .... With respect to any such action the following provisions shall apply:

> (1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.
>
> (2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances. 15 U.S.C. § 80a-35(b).

In *Gartenberg*, the Second Circuit analyzed § 36(b) and created the framework that has served as the starting point for interpreting a fund adviser's fiduciary duty. The plaintiffs in *Gartenberg* argued that, because of their fund's exponential growth, the adviser's fee had become so disproportionately large that it constituted a breach of fiduciary duty. After reviewing what the court called the "tortuous legislative history" of § 36(b), the Second Circuit concluded that the purpose of the provision was to mitigate the competitive deficiencies of the mutual fund industry. *See Gartenberg*, 694 F.2d at 928-29. Accordingly, the court held that the relevant test for a fee is whether it "represents a charge within the range of what would have been negotiated at arm's-length in light of all the surrounding circumstances." *Id.* at 928. The court then listed a number of non-exclusive factors that were germane to the analysis: (1) the nature and quality of the services provided by the adviser; (2) the profitability of the mutual fund to the adviser; (3) the extent to which "fall-out" benefits inured to the adviser; (4) the economies of scale realized by the adviser; (5) the

fee structures of comparable funds; and (6) the independence and conscientiousness of the board of directors. *Id.* at 928-31. In addition, the court offered some economic observations to assist the evaluation. For instance, the court noted that reliance on other fees throughout the industry will not satisfy § 36(b) because of the competitive defects of the mutual fund market. *See id.* at 929. The court ultimately concluded that the adviser's fee was not "so excessive or unfair as to amount to a breach of fiduciary duty within the meaning of § 36(b)." *Id.* at 930.

A number of courts have indicated approval of the *Gartenberg* framework in cases challenging adviser's fees under § 36(b). *See, e.g., Krantz v. Prudential Invs. Fund Mgmt. L.L.C.*, 305 F.3d 140 (3rd Cir. 2002) (following a Fourth Circuit analysis that was based on *Gartenberg*); *Migdal v. Rowe Price-Fleming Int'l*, 248 F.3d 321 (4th Cir. 2001); *Forsythe v. Sun Life Fin., Inc.*, 417 F. Supp. 2d 100 (D. Mass. 2006); *Sins v. Janus Capital Mgmt., L.L.C.*, 2006 WL 3746130 (D. Colo. 2006); *In re Dreyfus Mut. Funds Fee Litig.*, 428 F. Supp. 2d 342 (D. Pa. 2005); *Zucker v. AIM Advisors, Inc.*, 371 F. Supp. 2d 845 (S.D. Tex. 2005); *Strigliabotti v. Franklin Res., Inc.*, 2005 WL 645529 (N.D. Cal. 2005).

The Seventh Circuit eschewed the *Gartenberg* approach in *Jones v. Harris Associates*, 527 F.3d 627 (7th Cir. 2008). *Jones* rejected the proposition that courts should evaluate the reasonableness of an adviser's fee, holding that "[a] fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation." *Id.* at 632. The court based its conclusion on two fundamental premises: the plain meaning of the word "fiduciary" and a rejection of the economic assumptions inherent in *Gartenberg*. According to the court, the plain meaning of "fiduciary" is a requirement of "candor in negotiation, and honesty in performance" and nothing in

the obscure legislative history of § 36(b) alters that conclusion. *Id.* at 632-33. Furthermore, the court declared that the observations in *Gartenberg* about the lack of competitiveness in the mutual fund industry were flawed. Mutual funds, according to the court, "come much closer to the model of atomistic competition than do most other markets." *Id.* at 634. The court based this observation on the fact that there are thousands of mutual funds, and even if investors cannot control the fees set by any particular fund, they can assert indirect pressure on an adviser's compensation by choosing funds with lower fees. *See id.* at 632; *see also* John C. Coates & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 Iowa J. Corp. L. 151, 211 (2007) (arguing that there is robust competition within the mutual fund industry, though concluding that "*Gartenberg*'s three principal holdings are sensible from legal and economic perspectives").

The *Jones* opinion drew notable criticism within the court itself. Four judges joined Judge Richard Posner in a dissent from denial of rehearing en banc. *See Jones v. Harris Associates*, 537 F.3d 728, 729 (7th Cir. 2008) (Posner, J., dissenting from denial of rehearing en banc). Citing numerous academic studies, as well as financial-press articles, *id.* at 729-32, the dissent took issue with what it considered a tendentious economic analysis that was overly favorable to the mutual fund industry. *See id.* at 733. Additionally, the dissent chided the panel opinion for improperly rejecting a "comparison of the fees that [the defendant] charges independent funds with the much higher fees that it charges the funds it controls." *Id.* at 732. Overall, the dissent expressed the view that *Gartenberg* should not be abandoned and that judicial oversight of investment advisers should not be relaxed.

The Supreme Court has granted certiorari in *Jones*, No. 08-586, — U.S. —, 129 S. Ct. 1579, — L. Ed. 2d —

2009 WL 578699 (2009), leading some observers to suggest that the Court may establish a standard of review that may result in lower management fees. *See* Sam Mamudi, "Decision Could Set Standard on Fees," *Wall St. J.*, March 19, 2009, at C9.

III.

Our review of the cases, legislative history, and academic work surrounding § 36(b) leads us to conclude that the *Gartenberg* factors provide a useful framework for resolving claims of excessive fees, notwithstanding the substantial changes in the mutual fund industry that have occurred in the intervening years. Fund advisers do not have a fiduciary duty in merely an abstract sense. Rather, the duty is imposed "with respect to the receipt of compensation." As the Seventh Circuit acknowledged in *Jones*, a fee itself may be so large that it provides prima facie evidence that a breach of fiduciary duty has occurred. *See Jones*, 527 F.3d at 632.

At the same time, however, we think that *Jones* highlights a flaw in the way many courts have applied *Gartenberg*. The *Gartenberg* case demonstrates one way in which a fund adviser can breach its fiduciary duty; but it is not the only way. As did the Seventh Circuit, we read the plain language of § 36(b) to impose on advisers a duty to be honest and transparent throughout the negotiation process.[2] This conclusion is consistent with *Gartenberg*, in which the Second Circuit was addressing only the question of whether the fee itself was so high that it violated § 36(b).[3] The size of the adviser's fee is of course

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[2] The Third Circuit appears to have also adopted a broader, conduct-sensitive approach to § 36(b). *See Green v. Fund Asset Mgmt.*, 286 F.3d 682 (3d Cir. 2002).

[3] Indeed, *Gartenberg* does not address, much less overrule, *Galfand v. Chestnutt Corp.*, 545 F.2d 807 (2d Cir. 1976), an earlier case in which the Second Circuit concluded that an adviser violated its fidu-

one of the factors to be considered in reviewing a § 36(b) challenge to a fee structure. But the standard that the Second Circuit enunciated should not be construed to create a safe harbor of exorbitance, for under such a view an adviser's fiduciary duty would be diluted to a simple and easily satisfiable requirement not to charge a fee that is egregiously out of line with industry norms. To apply Gartenberg in this fashion across the entire mutual fund market would be to eviscerate § 36(b).[4]

We believe that the proper approach to § 36(b) is one that looks to both the adviser's conduct during negotiation and the end result. Cf. *In re Mutual Funds Investment Litigation*, 590 F. Supp. 2d 741, 760 (D. Md. 2008) ("To the extent that a portion of the fees paid to the investment adviser defendants was 'disproportionate, excessive, or unearned' . . . because it was based upon the existence of [improprieties] not disclosed when the fees were negotiated, plaintiffs . . . may recover that portion of the fees."). Unscrupulous behavior with respect to either can constitute a breach of fiduciary duty. It bears mention, of course, that Congress allocated the burden of proof to plaintiffs, both with respect to establishing the existence of a breach of fiduciary duty, *see* 15 U.S.C. § 80a-35(b)(1), as well as demonstrating the existence of cognizable financial harm resulting from that breach. *Id.* § 80a-35(b)(3).

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ciary duty under § 36(b) by "acquiring from the mutual fund, without full disclosure to the [board of directors], a patently one-sided revision of the advisory contract." *Id.* at 809.

[4] This may explain why no plaintiff has ever obtained a judgment in an action brought under that provision. *See* Johnson, *supra*, at 519 (noting that no investor has obtained a verdict against an investment adviser in the twenty-five years since *Gartenberg*).

IV.

We conclude that the district court erred in holding that no § 36(b) violation occurred simply because Ameriprise's fee passed muster under the *Gartenberg* standard. Although the district court properly applied the *Gartenberg* factors for the limited purpose of determining whether the fee itself constituted a breach of fiduciary duty, it erred in rejecting a comparison between the fees charged to Ameriprise's institutional clients and its mutual fund clients. In part, the court based its decision on dicta from *Gartenberg* that refused to compare the adviser's fees for fundamentally different investment vehicles—money market mutual funds and equity pension funds. *See Gartenberg*, 694 F.2d at 930 n.3. It does not follow, however, that a comparison will be irrelevant when there is greater similarity between the funds being compared. *See* Freeman & Brown, *supra*, at 645 ("The [*Gartenberg*] court's ruling on admissibility would have no force in an apples-to-apples suit where equity pension fund fee levels are compared to fee levels for an equity mutual fund."); *see also Jones*, 537 F.3d at 731 (Posner, J., dissenting from denial of rehearing en banc) ("A particular concern in this case is the adviser's charging its captive funds more than twice what it charges independent funds."). Indeed, the argument for comparing mutual fund advisory fees with the fees charged to institutional accounts is particularly strong in this case because the investment advice may have been essentially the same for both accounts.

We are also unpersuaded by the assertion that the fee disparity simply reflects what different investors are willing to pay. The purpose of an inquiry into the fees paid by institutional, non-fiduciary clients is to determine what the investment advice is worth. Advisers will argue that a comparison with institutional clients is inapt or that the discrepancy is substantively justified. As the

district court noted, this is exactly what Ameriprise attempted to do with its San Diego Office Review. There was, however, conflicting expert testimony on the accuracy and veracity of that report. Given the relevance of this evidence, the district court should have explored the disputed issues of material fact concerning the similarities and differences between mutual funds and institutional accounts.

Likewise, the district court should not have engaged in so limited a scope of review. Ameriprise's conduct must be evaluated independent from the result of the negotiation. The district court concluded that Ameriprise did not breach its fiduciary duty in one way (by setting a fee that was exorbitant relative to that of other advisers), but it should have also considered other possible violations of § 36(b). Specifically, the court should have determined whether Ameriprise purposefully omitted, disguised, or obfuscated information that it presented to the Board about the fee discrepancy between different types of clients. The record indicates that there are material questions of fact on this issue.

We remain mindful that § 36(b) does not allow a court "to substitute its business judgment for that of a mutual fund's board of directors in the area of management fees." *Gartenberg*, 694 F.2d at 928 (quoting S. Rep. No. 91-184 (1970), as reprinted in 1970 U.S.C.C.A.N. 4897 at 4902-03). Candid, transparent negotiation does not require discussion of every issue that a plaintiff might find relevant; and it does not require the adoption of a particular negotiation strategy.

Here, the plaintiffs made much of the fact that the negotiation focused on the advisory fees charged throughout the industry, arguing that this external focus was a per se breach of Ameriprise's fiduciary duty. But while tethering fees to an industry median will not provide sure-fire protection from § 36(b) liability, a negotiation

strategy similar to that employed in this case is not necessarily suspect. An effort to meet or surpass the value offered by one's primary competitors is a common business strategy, and there is no reason to assume it indicates bad faith.

V.

Finally, we address the question whether the statutory damage period ends with the filing of a § 36(b) lawsuit or continues throughout the litigation. Ameriprise contends that the plaintiffs cannot recover damages incurred after the filing date, but we disagree. The statute provides that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted." 15 U.S.C. § 80a-35(b)(3). It further states that damages "shall be limited to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payments received . . . ." *Id.*

Ameriprise argues that this language creates two temporal restrictions on § 36(b) damages. The first limitation is obvious: a plaintiff may not recover damages suffered more than one year before the lawsuit was filed. Beyond this, however, Ameriprise argues that the filing date provides an ending point, so that damages suffered *after* a plaintiff files suit are similarly unrecoverable. The district court adopted this view, which is consistent with brief dicta in *Daily Income Fund, Inc.*, 464 U.S. at 526 n.2, 104 S. Ct. 831. Ameriprise claims that this reading is also consistent with the structure of the ICA because investment advisory contracts must be approved annually. *See* 15 U.S.C. §§ 80a-15(a)(2), (b)(1).

The plain language of the statute, however, does not support this interpretation. As the United States District Court for the District of Massachusetts concluded in a thorough and carefully reasoned opinion, a straight-

forward reading of the damage limitation yields only a retrospective limitation. *See Dumond v. Massachusetts Fin. Servs. Co.*, 2007 WL 602589 (D. Mass. 2007). Of course, the annual recurrence of fee negotiation makes it less likely that the same conduct will cause damage over successive years. But where the plaintiffs have continued to suffer damage during the litigation, both the language of the statute and the interests of judicial economy suggest that redress should be available in a single action.

VI.

The judgment is reversed, and the case is remanded to the district court for further proceedings not inconsistent with the views set forth in this opinion.

APPENDIX B
IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No: 07-2945

JOHN E. GALLUS; ALEXANDRIA IONE FALLER, ALSO KNOWN AS ALEXANDRIA IONE GRIFFIN; DIANA J. ANDERSON, FOR THE USE AND BENEFIT OF THE RIVERSOURCE BALANCED FUND, FORMERLY KNOWN AS AXP MUTUAL FUND; RIVERSOURCE PRECIOUS METALS FUND, FORMERLY KNOWN AS AXP PRECIOUS METALS FUND; RIVERSOURCE MID CAP GROWTH FUND, FORMERLY KNOWN AS AXP EQUITY SELECT FUND; RIVERSOURCE SMALL CAP ADVANTAGE FUND, FORMERLY KNOWN AS AXP SMALL CAP ADVANTAGE FUND; RIVER SOURCE SMALL CAP VALUE FUND, FORMERLY KNOWN AS AXP PARTNERS SMALL CAP VALUE FUND; RIVERSOURCE MID CAP VALUE FUND, FORMERLY KNOWN AS AXP MID CAP VALUE FUND; RIVERSOURCE SMALL COMPANY INDEX FUND, FORMERLY KNOWN AS AXP SMALL COMPANY INDEX FUND; RIVERSOURCE HIGH YIELD BOND FUND, FORMERLY KNOWN AS AXP HIGH YIELD BOND FUND; RIVERSOURCE LARGE CAP EQUITY FUND, FORMERLY KNOWN AS AXP LARGE CAP EQUITY FUND, SUCCESSOR BY MERGER TO RIVERSOURCE NEW DIMENSIONS FUND AND AXP BLUE CHIP ADVANTAGE FUND,

Plaintiffs - Appellants,

v.

AMERIPRISE FINANCIAL, INC., FORMERLY KNOWN AS AMERICAN EXPRESS FINANCIAL CORPORATION; RIVERSOURCE INVESTMENTS, LLC; AMERIPRISE

FINANCIAL SERVICES, INC., FORMERLY KNOWN AS AMERICAN EXPRESS FINANCIAL ADVISORS, INC.
Defendants - Appellees.

Appeal from the U.S. District Court
for the District of Minnesota – Minneapolis
(0:04-cv-04498-DWF)

JUDGMENT

This appeal from the United States District Court was submitted on the record of the district court, briefs of the parties and was argued by counsel.

After consideration, it is hereby ordered and adjudged that the judgment of the district court in this cause is reversed and the cause is remanded to the district court for proceedings consistent with the opinion of this court.

April 08, 2009

Order Entered in Accordance with Opinion:
Clerk, U.S. Court of Appeals, Eighth Circuit.

/s/ Michael E. Gans

APPENDIX C
UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

CIVIL NO.: 04-4498 (DWF/SRN)

JOHN E. GALLUS; D. ELAINE GALLUS; ALEXANDRIA IONE FALLER FOR USE AND BENEFIT OF A/K/A ALEXANDRIA IONE GRIFFIN; AXP NEW DIMENSIONS FUND; AXP STRATEGY AGGRESSIVE FUND; AXP MUTUAL FUND; AXP PRECIOUS METALS FUND; AXP EQUITY SELECT FUND; AXP SMALL CAP ADVANTAGE FUND; AXP PARTNERS SMALL CAP VALUE FUND; AXP MID CAP VALUE FUND; AXP SMALL COMPANY INDEX FUND; AXP HIGH YIELD BOND FUND; AND AXP MANAGED ALLOCATION FUND SUCCESSOR BY MERGER TO AXP BLUE CHIP ADVANTAGE FUND,

Plaintiffs,

v.

AMERIPRISE FINANCIAL, INC., (F/K/A AMERICAN EXPRESS FINANCIAL CORPORATION); RIVERSOURCE INVESTMENTS, LLC AND AMERIPRISE FINANCIAL SERVICES, INC., (F/K/A AMERICAN EXPRESS FINANCIAL ADVISORS, INC.)

Defendants.

United States District Court,
D. Minnesota.

July 10, 2007

AMENDED MEMORANDUM OPINION AND ORDER

FRANK, District Judge.

On July 6, 2007, the Court docketed an Order granting Defendant's Motion for Summary Judgment and dismissing with prejudice the Amended Complaint[1] found at docket number 78. (*See* Doc. No. 200.) The Court now vacates that Order and enters this Amended Memorandum Opinion and Order, which is exactly the same as the July 6, 2007 Order found at docket number 200 except that this Order dismisses with prejudice the most recently filed Amended Complaint found at docket number 177.[2]

INTRODUCTION

This matter is before the Court pursuant to a Motion for Summary Judgment brought by Defendants American Express Financial Corporation, RiverSource Investments LLC, and American Express Financial Advisors Inc. (collectively, "Defendants"). For the reasons set forth below, the Court grants Defendants' motion.

BACKGROUND

Plaintiffs own an unspecified number of shares of eleven mutual funds in a family of funds known as the American Express Funds.[3] At least one of the Plaintiffs

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[1] Although the title of this Complaint is "Corrected Complaint Under Investment Company Act of 1940," the Court construes this Complaint as an Amended Complaint.

[2] For the purposes of this motion, the differences between the Amended Complaint found at docket number 177 and the Amended Complaint found at docket number 78 are immaterial.

[3] The "American Express Funds" or "the Funds" are the AXP New Dimensions Fund, the AXP Mutual Fund, the AXP Precious Metals Fund, the AXP Equity Select Fund, the AXP Small Cap Advantage Fund, the AXP Partners Small Cap Value Fund, the AXP Mid Cap

was a shareholder in each Fund during the applicable damage period—June 10, 2003, to June 9, 2004.[4] Defendants serve as the investment adviser and distributor of the American Express Funds. Each Fund pays the Defendants a fee for their services pursuant to a fee schedule. The Funds' board of directors (the "Board") negotiates the contracts containing the fee schedules on an annual basis.

Pursuant to these contracts, each Fund pays a management fee, based on a percentage of the Fund's net assets at the end of the preceding month, for the advisory and administrative services performed by the investment adviser. In addition, the fee covers certain administrative expenses. Each Fund also pays a distribution fee, based on a percentage of the Fund's net assets, for the costs of marketing and distributing fund shares.

The Board and Defendants meet several times during the annual process of negotiating and approving Defendants' fees. A Contracts Committee, comprised of Board members, reviews current contracts and makes recommendations to the entire Board as part of the process. The Contracts Committee met seven times during 2003 and three times during the six months in 2004 prior to the filing of the Complaint on June 9, 2004. Additionally, the Board sought the advice of independent counsel during the fee-negotiation process. The Board also re-

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Value Fund, the AXP Small Company Index Fund, the AXP High Yield Bond Fund, the AXP Managed Allocation Fund, and the AXP Blue Chip Advantage Fund. Each Fund is a registered investment company under the Investment Company Act ("ICA"), 15 U.S.C. § 80a-1, *et seq.*

[4] In an Order dated July 27, 2006, this Court held that damages are limited to the one-year period before the filing of the Complaint pursuant to 15 U.S.C. § 80a-35(b)(3). (*See* Mem. Op. & Order at 3-4, Doc. No. 163).

tained independent third-party consultants, KPMG, LLP ("KPMG"), to assist them during this process.

As part of the fee-negotiation process each year and pursuant to section 15(c) of the ICA, Defendants provide the Board with information regarding the services provided to the Funds; the personnel providing those services; the investment performance of the Funds; the profitability of the contracts to Defendants, including detailed information about Defendants' expenses; certain transactions between the Funds and entities affiliated with Defendants; benefits accruing to Defendants in addition to fees; and compliance information (collectively, the "15(c) materials"). The chair of the Contracts Committee and Board counsel review the 15(c) materials prior to the Board's annual renewal discussion, and draft memoranda to Defendants requesting supplementation, clarification or changes to the reports provided in the 15(c) materials.

In addition to reviewing the 15(c) materials, the Board in this case commissioned a third-party industry consultant, Lipper, Inc. ("Lipper"), to provide certain requested data for the Board's review. In particular, Lipper provided written materials on the comparison of the Funds' fees to those of a pool of the Funds' competitors. The Board was involved in the process by which Lipper selected the pool of Funds' competitors.

During the fee-negotiation process, the Board adopted a "pricing philosophy" for setting the Funds' fees that focused on the Funds' performance and pricing structure on a comparative basis to the Funds' relevant competitors. Specifically, the Board aspired to negotiate fees for the Funds that were at the median level of fees charged to comparable funds in the industry. The Board was willing to pay fees above the median when the Funds' performance was good, but sought to pay fees below the median when performance was poor. Arne Carlson,

Chairman of the Funds' Board, testified that "[i]t's an externally driven process. The overall business model is that our performance shall be at or above the median." (Decl. of Becky Ferrell-Anton ("Ferrell-Anton Decl."), Ex. D ("Carlson Dep.") at 128.) The pricing philosophy also incorporated considerations related to Defendants' distribution of the Funds, economies of scale, and profitability. The Lipper report showed that during the relevant period, each Fund was charged investment-management fees at or below the median of funds in their peer group.

The Board also requested that Defendants create a report that describes the similarities and differences between the fees charged and services provided to Defendants' non-mutual fund clients, including accounts of institutional investors ("institutional accounts") such as pension funds and the Funds. The report generally shows that the fees that institutional accounts pay are lower than those paid by the Funds. The report describes those additional services that Defendants provide to the Funds that Defendants do not provide to Defendants' institutional accounts. These additional services include additional compliance requirements, such as preparing and distributing prospectuses and other disclosures; oversight of third-party service providers, including the transfer agent and other intermediaries; director support, including director education and the preparation of quarterly materials for board meetings; and cash management.

The Board approved fee schedules for each Fund that feature "breakpoints," that is, asset levels at which the fees decline. The following tables display the fee schedules approved by the Board for the two Funds that were the subject of Plaintiffs' discovery efforts in this case. The tables show the percentage charged as a fee for the amount of the Fund's assets.

Blue Chip Advantage Fund	Large Cap Equity Fund & New Dimensions Fund
0.540% of the first $250 million	0.600% of the first $1 billion
0.515% of the next $250 million	0.575% of the next $1 billion
0.490% of the next $205 million	0.550% of the next $1 billion
0.465% of the next $250 million	0.525% of the next $3 billion
0.440% of the next $1 billion	0.500% of the next $6 billion
0.410% of the next $1 billion	0.490% of the next $12 billion
0.380% of the next $3 billion	0.480% of assets over $24 billion
0.350% of assets over $6 billion	

The Funds have generated investment returns generally above the median of their peer funds, as defined by Lipper. Specifically, the Lipper Report indicates that during the then-portfolio manager's tenure (through December 31, 2003), the New Dimensions Fund ranked within the first quartile of funds within its peer universe; the Blue Chip Advantage Fund ranked within the second quartile of funds within its peer universe; and the Large Cap Equity Fund ranked within the first quartile of funds within its peer universe. The contracts in this case also contained a Performance Incentive Adjustment matrix ("PIA"), which rewarded Defendants for performance better than the Lipper index of comparable funds, and penalized Defendants for under-performance.

On June 9, 2004, Plaintiffs filed this lawsuit on behalf of the Funds pursuant to sections 12(b) and 36(b) of the Investment Company Act of 1940 ("ICA"), 15 U.S.C.A. §§ 80a-12(b), 80a-35(b), alleging that the fees charged under the Funds' management and distribution agreements are excessive. The Complaint contains four counts. In Counts I and II of Plaintiffs' Complaint, Plain-

tiffs allege that the advisory fees charged by Defendants are excessive. In Count III, Plaintiffs allege that Defendants have breached their fiduciary duties under section 36(b) by collecting excessive distribution fees and by using the distribution fees as a method to obtain additional compensation for their advisory services. In Count IV, Plaintiffs allege that Defendants have failed to comply with the requirements of section 12(b).

Defendants subsequently brought a Motion to Dismiss all claims. In an Order dated March 7, 2005 (the "March 7, 2005 Order"), the Court granted Defendants' motion with respect to Count IV, but denied Defendants' motion with respect to Counts I through III. The parties then conducted discovery.[5] Defendants now bring this Motion for Summary Judgment on the remaining claims. In response to Defendants' motion, Plaintiffs rely on five expert reports.

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[5] In the March 7, 2005 Order, the Court held that Plaintiffs' Complaint survived the motion to dismiss by "only the narrowest of margins" and expressed doubt regarding the basis and veracity regarding certain allegations in the Complaint. (March 7, 2005 Order, Doc. No. 73.) Although the Court allowed Counts I through III to survive, the Court limited the scope of discovery based on the Court's view of the Complaint. Specifically, the Court directed Magistrate Judge Janie S. Mayeron to determine the parameters of the limited discovery process with the assistance of the parties. Magistrate Judge Mayeron ordered Plaintiffs to select two funds on which they were to focus the first phase of discovery. (See Pretrial Sch. Order at 1) (May 3, 2005). Plaintiffs selected the New Dimensions Fund and the Large Cap Equity Fund (as successor by merger to the Blue Chip Advantage Fund). Following the Court's March 7, 2005 Order, Plaintiffs filed a Corrected Amended Complaint, which eliminated many of the allegations in the Complaint regarding their excessive-fee claims.

DISCUSSION

I. Standard of Review

Summary judgment is proper if there are no disputed issues of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The Court must view the evidence and the inferences, which may be reasonably drawn from the evidence in the light most favorable to the nonmoving party. *Enter. Bank v. Magna Bank of Mo.*, 92 F.3d 743, 747 (8th Cir. 1996). However, as the Supreme Court has stated, "[s]ummary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed 'to secure the just, speedy, and inexpensive determination of every action.'" *Celotex Corp. v. Catrett*, 477 U.S. 317, 327, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986) (quoting Fed. R. Civ. P. 1).

The moving party bears the burden of showing that there is no genuine issue of material fact and that it is entitled to judgment as a matter of law. *Enter. Bank*, 92 F.3d at 747. The nonmoving party must demonstrate the existence of specific facts in the record that create a genuine issue for trial. *Krenik v. County of Le Sueur*, 47 F.3d 953, 957 (8th Cir. 1995). A party opposing a properly supported motion for summary judgment "may not rest upon mere allegations or denials of his pleading, but must set forth specific facts showing that there is a genuine issue for trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986).

II. The ICA

Congress passed the ICA in order to protect investors' interests. 15 U.S.C. § 80a-1, *et seq.* Pursuant to the ICA, fund investment advisers serve pursuant to written management contracts approved by a majority of the fund's shareholders, such contracts must thereafter be ap-

proved annually by the fund's board of directors or a majority of shareholders. 15 U.S.C. §§ 80a-15(a), 80a-2(a)(12). The board negotiates the compensation to be paid to the advisers on behalf of the shareholders and in their best interests. *Id.* at § 80a-15(c). The board is required to request and evaluate such information from the adviser as may be reasonably necessary to evaluate the terms of the proposed contract and the adviser must supply such requested information. *Id.* No more than sixty percent of the fund's board of directors can be comprised of "interested persons" of the fund, as defined by section 2(a)(19).[6] *Id.* at §§ 80a-2(a)(19), 80a-10(a).

III. Counts I and II

Defendants request that the Court grant summary judgment on Plaintiffs' claims that Defendants charged excessive advisory fees in violation of its obligations under section 36(b) of the ICA. Section 36(b) of the ICA imposes a fiduciary duty on mutual fund investment advisers in connection with their receipt of fees from the funds they manage. 15 U.S.C. § 80a-35(b). The statute provides, in relevant part,

> [T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser.

15 U.S.C. § 80a-35(b). The statute also provides that the funds' shareholders have a right to bring a derivative action against the adviser for alleged breaches of that fiduciary duty in connection with the receipt of compensation.

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[6] In this case, nine of the twelve board members (or 75%) were "disinterested" during the relevant period, thereby satisfying this requirement of the ICA.

Id. Further, section 36(b)(1) provides that "the plaintiff shall have the burden of proving a breach of fiduciary duty."

The seminal case on section 36(b) is *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982). In *Gartenberg*, the Second Circuit held that in order to violate section 36(b), an "advisor-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Id.* at 928. To make this determination, a court must consider all pertinent facts, including: (1) the nature and quality of the services provided by the adviser to the shareholders; (2) the profitability of the mutual fund to the adviser; (3) "fall-out" benefits;[7] (4) the economies of scale realized by the adviser; (5) comparative fee structures with similar funds; and (6) the independence and conscientiousness of the independent trustees. *Id.* at 928-31. Defendants assert that there is no genuine issue of material fact based on the evidence relating to the *Gartenberg* factors regarding whether the fees could not have been the product of arm's-length bargaining under section 36(b). In response, Plaintiffs contend that application of the *Gartenberg* factors shows that the advisory fees were excessive. The Court will address the parties' arguments regarding the *Gartenberg* factors.[8]

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[7] "Fall-out" benefits are those benefits other than the advisory fees that flow to the adviser or its affiliates as a result of the adviser's relationship with the fund. *See Levy v. Alliance Capital Mgmt. L.P.*, No. 97 Civ. 4672(DC), 1998 WL 744005, *2 (S.D.N.Y. Oct. 26, 1998).

[8] Although Plaintiffs assert that *Gartenberg* does not set forth the appropriate test in this case, as the Court stated in its March 7, 2005 Order, the Court will analyze Plaintiffs' section 36(b) claims under the standard set forth in *Gartenberg*. (*See* March 7, 2005 Order at 5, Doc. No. 73.)

A. Nature and Quality of the Services

Defendants contend that Plaintiffs do not challenge the data reviewed by the Board regarding the nature and quality of services Defendants provided to the Funds. Specifically, Defendants assert that the Board was provided with data reflecting the amount the shareholders receive in return for their fees, including reports of the Funds' net investment performance relative to benchmarks and other funds. Defendants also assert that the Board was provided with detailed descriptions of the services provided by Defendants to the Funds and the shareholders, the personnel providing those services, and detailed information about Defendants' expenses. Further, Defendants contend that the Board received information regarding certain transactions between the Funds and entities affiliated with Defendants, benefits accruing to Defendants in addition to fees, and compliance information, including information about the best execution of portfolio transactions for each Fund, allocation of purchase and sale transactions among broker-dealers, and compliance with the Funds' investment restrictions.

In response, Plaintiffs assert that Defendants put their own financial interests ahead of their clients' interest and that performance of the Funds was poor during the damages period. In particular, Plaintiffs suggest that Defendants and their affiliates have a long record of violating the law relating to their mutual fund activities that has resulted in almost $80 million in fines during the damages period for breaching their fiduciary duties to clients. Plaintiffs also allege that their expert, Steve Pomerantz, will testify that the performance of the Funds was poor during the applicable damages period.

Viewing the facts in the light most favorable to Plaintiffs, the Court finds that there are no genuine issues of material fact regarding whether the fee was so dispro-

portionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining. Here, the regulatory settlements that Plaintiffs identify focus on activities that are not connected to Defendants' conduct as investment adviser to the Funds. Plaintiffs fail to establish a link between the practices at issue in the regulatory settlements and the value of services paid for by the challenged fees. Further, Plaintiffs' characterization of the undisputed performance figures as "poor" does not create a genuine issue of material fact. Plaintiffs do not allege that the performance figures were incorrect or that Defendants improperly reported them. Furthermore, Plaintiffs do not address the fact that the Funds' fees were subject to PIAs that reduced fees if performance was in fact "poor." Accordingly, Plaintiffs' claims cannot survive summary judgment based on this *Gartenberg* factor.

B. Profitability of the Mutual Fund to the Adviser

Defendants assert that Plaintiffs' challenge to the directors' profitability report does not describe or quantify the effect of any supposed failings in the report. In response, Plaintiffs contend that the profitability reports that Defendants provided to the directors were misleading. In particular, Plaintiffs point to their expert Bruce Dubinsky, who opines that the allocation methodology Defendants used to determine profitability was unreliable and that the board was not provided with sufficient data to enable it to properly evaluate the true financial profitability of the Funds. Plaintiffs also contend that Dubinsky will testify that the lack of adequate detail in Defendants' costing system makes quantifying the effect of Defendants' flawed costing methodology nearly impossible.

Viewing the facts in the light most favorable to Plaintiffs, the Court finds that there are no genuine issues of

material fact regarding whether the fee was so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining. Plaintiffs do not dispute that Defendants provided detailed reports on its profitability to the Board. Instead, Plaintiffs' expert takes issue with how the information was presented to the Board by criticizing the cost allocation methodology used. Although Plaintiffs suggest that the Board should have had different information than what the Board was provided, Plaintiffs do not point to any authority detailing requirements for the presentation of profitability data. Furthermore, Plaintiffs fail to show how any such failings in the data create a genuine issue of material fact regarding whether the board negotiates the fees at arm's length. Accordingly, Plaintiffs' claims cannot survive summary judgment based on the profitability factor.

C. "Fall-Out" Benefits

Defendants assert that any fall-out benefits were fully disclosed to the Board. Defendants point out that Defendants provided the Board with a report that addressed the fall-out benefits it believed it enjoyed as a result of the advisory relationship. In particular, Defendants note that it identified so-called "soft-dollar" arrangements in a report to the Board. In response, Plaintiffs assert that Defendants receive an enormous fall-out benefit in being able to resell the services that Defendants have already provided to the Funds to institutional clients and that the Board never took this benefit into account.

Viewing the facts in the light most favorable to Plaintiffs, the Court finds that no genuine issue of material fact exists regarding the disclosure and consideration of fall-out benefits that would suggest that the Board's fee-negotiation process could not have been an arm's-length one. Here, Plaintiffs do not dispute that the Board considered the reports that Defendants provided to them

that expressly addressed the fall-out benefits when negotiating fees with Defendants. Instead, Plaintiffs assert that the profitability or cost data with respect to institutional business constitutes a fall-out benefit. This assertion does not create a genuine issue of material fact under the standard and, therefore, Plaintiffs' claims cannot survive summary judgment based on fall-out benefits.

D. Economies of Scale

Defendants assert that it is undisputed that the Funds have "breakpoints" that cause the fees to drop as the Funds grow in size and that Plaintiffs' economies-of-scale experts take no account of the effect of these breakpoints. Plaintiffs, on the other hand, assert that Defendants realized enormous economies of scale in connection with their asset-management business but contend that the breakpoints in Defendants' advisory fee schedules did not appropriately share economies of scale with the Funds' shareholders. Plaintiffs point to their experts, Pomerantz and Edward O'Neal, who conclude that Defendants realize significant economies of scale. In addition, Plaintiffs point to Pomerantz's calculation that during the relevant damages period, Defendants realized $74 million in cost savings due to economies of scale for the New Dimensions Fund, but shared only $12.7 million of those savings with the Fund shareholders through breakpoints, thereby retaining the remaining $61.3 million. Finally, Plaintiffs contend that Defendants shared significantly more economies of scale with its institutional clients.

Viewing the evidence in the light most favorable to Plaintiffs, the Court finds that no genuine issue of material fact exists regarding whether the fee schedules could not have been negotiated at arm's length. Plaintiffs do not dispute that breakpoints in the Funds' fee schedules served to share some economies of scale. Instead, Plaintiffs' argue that the breakpoints did not appropriately

share economies of scale. But Plaintiffs do not establish why the existing breakpoints so inadequately shared the cost savings, such that the fee schedules could not have been the product of arm's-length bargaining. Plaintiffs' experts do not identify what amount of cost savings would have been appropriate, or why the amounts shared fall outside the range that could have been negotiated at arm's length. Accordingly, Plaintiffs' claims cannot survive summary judgment based on the economies-of-scale factor.

E. Comparative Fee Structure with Similar Funds

Defendants contend that Plaintiffs' comparative-fee-structure analysis focuses on an irrelevant comparison between mutual fund fees and non-mutual fund fees. Further, Defendants contend that the record reflects no competent evidence demonstrating a factual predicate for Plaintiffs' assertion that Defendants are charging other clients different fees for the same services. Additionally, Defendants contend that Plaintiffs ignore the data considered by the Board comparing the Funds to other comparable mutual funds.

Plaintiffs, on the other hand, contend that the comparison of non-mutual fund, institutional-client fees to mutual-fund fees is legally relevant in section 36(b) cases. Further, Plaintiffs allege that Defendants' retail mutual funds and institutional accounts were receiving comparable services. Plaintiffs also contend that Defendants provided some limited information to their Board members on institutional fees for the first time in March 2004, but that that this information was not available to the Board when they approved the advisory fees at issue in this case.

Regarding the comparative-fee-structures factor, the *Gartenberg* court rejected plaintiffs' assertion that "the lower fees charged by investment advisers to large pension funds should be used as a criterion for determining

fair advisory fees for money market funds[.]" *Gartenberg*, 694 F.2d at 930 n.3. That court further explained that the nature and extent of the services required by each type of fund was different. *Id.* Since *Gartenberg*, courts have held that other mutual funds provide the relevant comparison for measuring fees—not non-mutual fund institutional clients. *See, i.e., Strougo v. Bea Assocs.*, 188 F. Supp. 2d 373, 384 (S.D.N.Y. 2002).

Here, even if comparing mutual fund fees to non-mutual fund fees is relevant, Plaintiffs have not demonstrated that the services provided to the different types of funds are comparable. Instead, the evidence shows that Defendants provided the Board with a report showing that the services provided to the Funds were different than those provided to the institutional clients. Moreover, a district court in Illinois recently stated that "[e]ven assuming for the mere sake of comparison that the services [the adviser's] institutional clients received were indistinguishable from those the Funds received, the amounts paid by different parties establish a range of prices that investors were willing to pay." *Jones v. Harris Assocs., L.P.*, No. 04-C-8305, 2007 WL 627640, at *8 (N.D. Ill. Feb. 27, 2007). Thus, the fact that Defendants did not compare the Funds' fees to those of its institutional clients does not create a genuine issue of material fact regarding whether the fees could not have been negotiated as a result of arm's-length bargaining.

Furthermore, the Board received data comparing the Funds' fees to a relevant peer group—competitor mutual funds of a similar size that pursue the same investment objectives through active management. Plaintiffs do not challenge the accuracy or validity of the Lipper data or the accuracy or validity of the Board's analysis of the process by which Lipper selected the comparable peer funds for each Fund. Considering this data, Plaintiffs have not identified a genuine issue of material fact as to

whether the fees are so disproportionately excessive that they could not have been the product of arm's-length negotiation. Accordingly, Plaintiffs' claims cannot survive summary judgment based on this factor.

F. Independence and Conscientiousness of the Independent Trustees

Defendants assert that Plaintiffs have not adduced evidence to suggest that the Board members were not independent and qualified to serve as the Funds' Board members. Defendants contend that Plaintiffs do not challenge that the Board met regularly and played an active role in the negotiation process, or that the Board consulted independent counsel and other third-party consultants as necessary to inform their understanding of the contract negotiations. Additionally, Defendants contend that Plaintiffs do not contest that Defendants provided to the Board a wide range of information covering all the Gartenberg factors in the 15(c) materials. Defendants also contend that Plaintiffs do not contest that the chair of the Contracts Committee and Board counsel reviewed the 15(c) materials prior to their annual discussion; drafted memoranda to Defendants requesting supplementation, clarification, or changes to the reports provided in the 15(c) materials; and regularly requested additional information from Defendants.

In response, Plaintiffs contend that the Board followed a flawed process in establishing the advisory fees charged to the funds. Specifically, Plaintiffs allege that, in practice, the Board focused exclusively on comparing the Funds' fees and performance to those of other retail mutual funds, and did not take into account the other *Gartenberg* factors. Additionally, Plaintiffs contend that the Board members could not properly consider all the *Gartenberg* factors because Defendants failed to provide them with sufficient and reliable information.

Viewing the evidence in the light most favorable to Plaintiffs, the Court finds that no genuine issue of material fact exists as to whether this process was not an arm's-length one. Plaintiffs do not challenge the board members' independence. Plaintiffs do not dispute that the Board met regularly, played an active role in the contract negotiation process, and sought the advice of independent counsel and consultants. The evidence does not support Plaintiffs' assertion that the Board admits that it exclusively focuses on fees charged to peer mutual funds when setting the fees. While the Board may have placed greater emphasis on fees charged to peer mutual funds than Plaintiffs would have liked, such evidence does not create a genuine issue of material fact that the process was not an arm's-length one. Additionally, while Plaintiffs contend that the information Defendants provided the Board was misleading, Plaintiffs fail to describe how these alleged deficiencies affected the results of the Board's fee-negotiation process. Plaintiffs' attacks do not establish that the care and conscientiousness of the Board was lacking and ultimately fail to create a genuine issue of material fact regarding whether the fees could not have been the result of arm's-length bargaining.

In conclusion, after weighing all of the *Gartenberg* factors, the Court finds that Plaintiffs have failed to establish a genuine issue of material fact regarding whether the fees charged were so disproportionately large that they bear no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining. Here, the Board sets Defendants' fees at the median amount charged to comparable funds in the industry, the fees include breakpoints that share economies of scale with shareholders as the Funds grow, and the fees are subject to performance-incentive adjustments that further decrease the fees if a Fund's performance does not exceed an agreed benchmark.

Plaintiffs' primary argument that Defendants' fees are excessive is that non-mutual fund institutional accounts pay Defendants lower fees than the Funds. But as stated above, this argument lacks merit and fails to create a genuine issue of material fact.

While the evidence in this case may show that the Board could have negotiated lower fees, whether the fees could have been lower is not the question the Court is required to address under the applicable standard. *See Gartenberg*, 528 F. Supp. at 1047 ("[I]n order to provide relief under Section 36(b), it is not enough for this Court to find that a better bargain was possible.") Because the evidence relating to the Gartenberg factors raises no genuine issue of material fact under section 36(b) that the fees could not have been the product of arm's-length bargaining, Defendants are entitled to summary judgment on Counts I and II.[9] *See Jones*, 2007 WL 627640, at *9 (holding that the plaintiffs failed to "set forth an issue of

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[9] Defendants seek summary judgment on all of the Funds, asserting that the record of the fee-negotiation process and its results is fully developed. Plaintiffs, on the other hand, contend that Defendants' request for summary judgment on all claims is inappropriate because Plaintiffs were only provided discovery on two of the Funds and only allowed to depose two of the disinterested directors of the Funds. Therefore, Plaintiffs assert that summary judgment is inappropriate under Federal Rule of Civil Procedure 56(f) because Plaintiffs have not completed adequate discovery.

The Court finds that Defendants are entitled to summary judgment on all of the Funds. Because the record of the fee-negotiation process is complete, additional discovery will not add anything new to the record. Here, the discovery materials that Defendants provided were not redacted or limited to be fund-specific. Furthermore, the Court directed Defendants "to file a motion for reconsideration after the initial discovery has been completed" so that the Court could reconsider dismissing the case. (March 7, 2005 Order at 8, Doc. No. 73.) Accordingly, Defendants' summary judgment motion is not unanticipated at this juncture.

fact that, if resolved in their favor, could lead to a finding that [the adviser] had breached its § 36(b) duty.")

IV. Count III

In Count III of the Complaint, Plaintiffs allege that Defendants charged excessive section 12(b) distribution fees in violation of their obligations under section 36(b) of the ICA.[10] As with their excessive advisory-fees claim, Plaintiffs must prove that the fee "is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Gartenberg*, 694 F.2d at 928.

Defendants contend that Plaintiffs' challenge to Defendants' 12b-1 distribution fees are not actionable under section 36(b). In particular, Defendants contend that Plaintiffs do not attempt to establish that Defendants' 12b-1 distribution fees are excessive under section 36(b) as alleged in the Complaint, but rather challenge the validity of such fees in general. Additionally, Defendants contend that Plaintiffs provided no analysis of the 12b-1 distribution fees under relevant section 36(b) standards because they ignore the evidence of the different services actually paid for by the 12b-1 fees. In particular, Defendants point out that Plaintiffs' expert's comparison of the level of the 12b-1 fee with potential savings from economies of scale in other fees such as investment-management fees ignores the evidence showing that up to 85% (or 21.25 basis points) of the 25 basis-point 12b-1

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[10] In the March 7, 2005 Order, the Court stated that it had "considerable concerns" about whether "Plaintiffs are attacking only the Funds' distribution fee rate or if Plaintiffs are attacking the ability of the mutual fund industry to charge existing shareholders these fees *in toto*." (March 7, 2005 Order, Doc. No. 73.) The Court therefore held that Plaintiffs should only be granted a limited form of discovery that focused on the distribution fees actually paid by the Funds in this case. (*Id.*)

fee for Class A shares covers shareholder servicing to existing shareholders, not the marketing of fund shares to new shareholders.

In response, Plaintiffs assert that Defendants breached their fiduciary duty under section 36(b) with regard to the distribution fees by failing to provide the directors with all necessary information required by Rule 12b-1. Specifically, Plaintiffs contend that Defendants have never provided the Board with a cost-benefit analysis showing the costs of the 12b-1 Plans in comparison to their potential benefits. Plaintiffs also contend that in exchange for the 12b-1 fees, the shareholders received no material benefit. Instead, Plaintiffs contend that any rewards realized went solely to Defendants.

Here, Plaintiffs ignore the evidence showing that approximately 85% of Defendants' 12b-1 distribution fees were paid for services to existing shareholders and not to marketing the Funds to new shareholders. Thus, Plaintiffs' claim that existing shareholders received absolutely "no material benefit" from these services is without merit. Furthermore, the evidence shows that the Board has, in fact, considered the benefits of the full set of services provided pursuant to Defendants' 12b-1 distribution fees. Viewing the evidence in the light most favorable to Plaintiffs, the Court finds that Plaintiffs have not established a genuine issue of material fact regarding whether the 12b-1 fee is so disproportionate to the full set of services Defendants provided to the shareholders that it could not have been the product of arm's-length bargaining. Accordingly, Defendants are entitled to summary judgment on Count III of Plaintiffs' Complaint.

CONCLUSION

Accordingly, **IT IS HEREBY ORDERED** that:

1. Defendants' Motion for Summary Judgment (Doc. No. 178) is **GRANTED**.

2. Plaintiffs' Amended Complaint (Doc. No. 177) is **DISMISSED WITH PREJUDICE.**

LET JUDGMENT BE ENTERED ACCORDINGLY.

APPENDIX D
UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

CIVIL NO.: 04-4498 (DWF/SRN)

JOHN E. GALLUS; D. ELAINE GALLUS; ALEXANDRIA IONE FALLER (A/K/A ALEXANDRIA IONE GRIFFIN); FOR THE USE AND BENEFIT OF AXP NEW DIMENSIONS FUND; AXP STRATEGY AGGRESSIVE FUND; AXP MUTUAL FUND; AXP PRECIOUS METALS FUND; AXP EQUITY SELECT FUND; AXP SMALL CAP ADVANTAGE FUND; AXP PARTNERS SMALL CAP VALUE FUND; AXP MID CAP VALUE FUND; AXP SMALL COMPANY INDEX FUND; AXP HIGH YIELD BOND FUND; AXP MANAGED ALLOCATION FUND, AND AXP LARGE CAP EQUITY FUND (SUCCESSOR BY MERGER TO AXP BLUE CHIP ADVANTAGE FUND),

Plaintiffs,

V.

AMERICAN EXPRESS FINANCIAL CORPORATION AND AMERICAN EXPRESS FINANCIAL ADVISORS, INC.)

Defendants,

AND

RIVERSOURCE FUNDS AND ITS INDEPENDENT DIRECTORS,

Movant.

MEMORANDUM OPINION AND ORDER

DONOVAN W. FRANK, United States District Court Judge.

This matter is before the Court on Defendants' and Plaintiffs' appeal of or objections to Magistrate Judge Susan Richard Nelson's Order dated May 30, 2006 (the "Order"), in which Magistrate Judge Nelson granted in part and denied in part Plaintiffs' Motion to Compel Discovery, granted Plaintiffs' Motion to Amend/Correct the Complaint, and granted in part and denied in part Plaintiffs' Motion to Quash a Subpoena and for a Protective Order. Specifically, Plaintiffs appeal or object to Magistrate Judge Nelson's legal conclusions regarding the applicable damage period and Defendants appeal Magistrate Judge Nelson's decision to allow Plaintiffs to amend the Complaint to replace Plaintiff D. Elaine Gallus with Diana Anderson. For the reasons set forth below, the Court denies the parties' appeals or objections.

ORDER

1. Plaintiffs' objections to or appeal of (Doc. No. 143) Magistrate Judge Susan Richard Nelson's Order dated May 30, 2006, are **DENIED**.

2. Defendants' appeal (Doc. No. 144) of Magistrate Judge Susan Richard Nelson's Order dated May 30, 2006, is **DENIED**.

3. Magistrate Judge Susan Richard Nelson's Order dated May 30, 2006 (Doc. No. 134) is **AFFIRMED**.

Dated: July 27, 2006

s/Donovan W. Frank
DONOVAN W. FRANK
Judge of United States District Court

MEMORANDUM

Magistrate Judge Nelson found that Plaintiffs' discovery requests related to post-Complaint damages are not relevant and held that Defendants need not respond

to such requests. Magistrate Judge Nelson's determination was based on her decision that, under the Investment Company Act of 1940 ("ICA"), damages are limited to the one-year period before the filing of the action. Specifically, the ICA states, "No award of damages shall be recoverable for any period prior to one year before the action was instituted." ICA § 36(b), 15 U.S.C. § 80a-35. Plaintiffs object to Magistrate Judge Nelson's determination that, under the ICA, damages are limited to the one-year period before the filing of the action. Plaintiffs assert that Magistrate Judge Nelson's determination is contrary to the plain language of the statute and the case law interpreting it.

Without reaching the issue of whether the Court is required to review Magistrate Judge Nelson's decision on a *de novo* basis or under a clearly erroneous standard of review, the Court finds that Magistrate Judge Nelson's interpretation of the statute should be upheld under either standard. After reviewing the applicable case law, the Court concludes that, under the ICA, damages are limited to the one-year period before the filing of the action. The two cases that Plaintiffs rely on, but did not cite to Magistrate Judge Nelson, are distinguishable. Although the court in *Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 663 F. Supp. 962, 963 n.2 (S.D.N.Y. 1987) noted that its relevant time period was April 1979 to February 1981, the parties stipulated to that time period. Here, Defendants have not stipulated to a time period that exceeds the one-year damage limitation under the ICA. Moreover, the court's perfunctory acceptance in *Krinsk v. Fund Asset Management, Inc.*, 715 F. Supp. 472, 476 (S.D.N.Y. 1988), that the time period extended from May 1984 to December 1986 has no precedential value in light of the other relevant case law. Further, the Court finds that the legislative history corroborates

Magistrate Judge Nelson's interpretation of the statute. Accordingly, Plaintiffs' objection is denied.

The Court also denies Defendants' appeal of Magistrate Judge Nelson's Order granting Plaintiffs' Motion to Amend the Complaint to replace plaintiff D. Elaine Gallus with another shareholder, Diana Anderson. The Court must modify or set aside any portion of the Magistrate Judge's order found to be clearly erroneous or contrary to law. *See* 28 U.S.C. § 636(b)(l)(A); Fed. R. Civ. P. 72(a); Local Rule 72.1(b)(2). The Court finds that Magistrate Judge Nelson's finding of good cause was not clearly erroneous or contrary to law. As Magistrate Judge Nelson indicated in the Order, there is no evidence that Plaintiffs knew that Mrs. Gallus would not want to remain in the suit. Instead, the evidence shows that Mrs. Gallus simply changed her mind about wanting to participate in the legal process. On the facts of this case, Magistrate Judge Nelson's decision to permit the Plaintiffs to amend their Complaint to substitute Mrs. Anderson as a named Plaintiff was not clearly erroneous or contrary to law.

For these reasons, the Court affirms Magistrate Judge Susan Richard Nelson's order dated May 30, 2006.

D.W.F.

APPENDIX E
UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

CIVIL NO. 04-CV-4498 (DWF/SRN)

JOHN E. GALLUS, ET AL.,
Plaintiffs,

v.

AMERICAN EXPRESS FINANCIAL CORPORATION, AND AMERICAN EXPRESS FINANCIAL ADVISORS, INC.,
Defendants.

ORDER

SUSAN RICHARD NELSON, United States Magistrate Judge

This matter is before the Court upon Plaintiffs' Motion to Compel Discovery (Doc. No. 105); Plaintiff's Motion to Amend/Correct the Complaint (Doc. No. 108) and Plaintiff's Motion to Quash a Subpoena and for a Protective Order (Doc. No. 111). This case has been referred to the undersigned for resolution of pretrial matters pursuant to 42 U.S.C. § 636 and Local Rule 72.1.

I. BACKGROUND

Plaintiffs allege that they own a number of shares of eleven mutual finds in a family of funds formerly known as the American Express Funds. Defendants Ameriprise Financial, Inc. (formerly American Express Financial Corporation) and Ameriprise Financial Services, Inc. (formerly American Express Financial Advisors, Inc.) serve as advisor and distributor of the Funds and are

both based in Minnesota. Defendants' services are provided pursuant to agreements approved by the Board of Directors of the Funds.

Under each of these agreements, the Funds pay certain fees for the services Defendants provide. Each Fund pays a management fee, based on a percentage of the Fund's net assets, for the advisory and administrative services performed by the investment manager. The fee compensates Ameriprise for its services as an investment advisor to the Fund and also covers certain administrative expenses.

Plaintiffs' Complaint alleges violations of § 36(b) of the Investment Company Act of 1940 (ICA), claiming that Defendants' fees under the Funds' management and distribution agreements are excessive. In Counts I and II of Plaintiffs' Complaint, they allege that the advisory fees charged by Defendants are excessive. In Count III, Plaintiffs allege that Defendants breached their fiduciary duties under § 36(b) by collecting excessive distribution fees and by using the distribution fees as a method of obtaining additional compensation for their advisory services.

Plaintiffs move the Court for leave to file an Amended Complaint for a number of reasons. First, Plaintiffs move to substitute a named Plaintiff because D. Elaine Gallus, a security holder representing the claims of the AXP Large Cap Equity Fund, no longer wishes to represent the fund in this action. Plaintiffs contend that the claims of the proposed substitute plaintiff are identical to those of Ms. Gallus. In addition, Plaintiffs seek to add a security holder representing the AXP Mutual Fund (now known as RiverSource Mutual Fund) and the former AXP New Dimensions Fund (now known as RiverSource New Dimensions Fund). In addition, Plaintiffs seek leave to revise and drop certain claims and allegations. Finally, Plaintiffs wish to revise the Complaint as a result

of Defendants' corporate restructuring, fund mergers, and consequent name changes, and modify the case caption accordingly.

Defendants oppose Plaintiffs' motion to amend on several grounds. First, as to the substitution of a new shareholder plaintiff, Defendants contend that Plaintiffs' motion is untimely and requires a showing of "good cause" under Fed. R. Civ. P. 16(b). Defendants also object to Plaintiffs' motion as to the deletion of certain allegations questioned by Judge Frank in a March 2005 Order. Defendants contend that they expended considerable effort and costs in response to discovery related to these claims. Therefore, if the Court grants Plaintiffs' motion, Defendant propose that this Court impose the following conditions upon this "amendment:" (1) Plaintiffs should be prevented from presenting at trial any evidence relating to the deleted allegations; and (2) Plaintiffs should be required to respond to Ameriprise's discovery requests, including the deposition of Mrs. Gallus, regarding the basis for including the deleted allegations in the Complaint. To the extent that Plaintiffs' motion merely reflects recent name and structural changes at Ameriprise and the RiverSource Funds (formerly American Express Funds), Defendants do not object. Nor do Defendants object to the deletion of Count IV from the Complaint, which Judge Frank dismissed in his March 2005 Order.

In their motion to compel, Plaintiffs seek damages discovery for the period after June 9, 2004, the date of the filing of the Complaint. Plaintiffs contend that damages are recoverable in an ICA § 36(b) action for the period beginning one year prior to filing the complaint up to, and including, the date of trial. Plaintiffs argue that § 36(b) actions, by their very nature, involve a continuing wrong, i.e., charging of excessive fees to a mutual fund. In addition, Plaintiffs seek an order ruling that all depositions conducted pursuant to the Plaintiffs' Rule 30(b)(6)

deposition notice will count as one deposition for purposes of the deposition limit in this case. Finally, Plaintiffs seek more complete discovery in response to "Topic 7" of their 30(b)(6) notice.

Defendants respond that Plaintiffs are not permitted to post-Complaint discovery under the ICA. As to the number of dispositions, Defendants argue that each of the fourteen depositions taken by Plaintiffs to date should be counted separately for purposes of Plaintiffs' fifteen-deposition limit. Lastly, Defendants contend that Plaintiffs' request for additional "Topic 7" discovery should be denied as moot, because the witness who testified on this topic subsequent to the filing of Plaintiffs' motion covered the topic in full.

Plaintiffs also move the Court for an Order to quash the May 14, 2006 subpoena issued to Mrs. Gallus for her deposition and for a protective order prohibiting Defendants from taking her deposition.

II. DISCUSSION

A. Motion to Amend

Although leave to amend the pleadings shall be "freely given when justice so requires," where the pretrial scheduling order's deadline for amendments has passed, "a schedule shall not be modified except upon a showing of *good cause* and by leave of the district judge or, when authorized by local rule, by a magistrate judge." Fed. R. Civ. P. 15 and 16(b)(6) (emphasis added.) The "good cause" standard is exacting, for it demands a showing that the existing schedule "cannot reasonably be met despite the diligence of the party seeking the extension." Fed. R. Civ. P. 16(b)(6), Advisory Committee Note—1983 Amendment. "It hardly bears mention, therefore, that 'carelessness is not compatible with a finding of diligence and offers no reason for a grant of relief.'" *Engleson v. Little Falls Area Chamber of Commerce*, 210 F.R.D. 667,

668-69 (D. Minn. 2002) (citations omitted), *aff'd*, 362 F.3d 525 (8th Cir. 2004). Nor does the finding of good cause turn on the absence or existence of prejudice to the non-moving party. *Id.* Where the moving party fails to provide a demonstration of good cause, its proposed amendment may be denied. *See id.* at 670 (stating, "[W]e conclude that Engleson's failure to comply with the established expect disclosure deadline was not substantially justified, as we are provided with no cause, let alone good cause, for the late disclosure of that opinion evidence.") The Pretrial Scheduling Order in this case required that all motions to amend the pleadings be served and filed on or before April 15, 2005. (Doc. No. 81.)

As to the showing of good cause, Defendants cite *In re Milk Products Antitrust Litigation*, 195 F.3d 430, 437-38 (8th Cir. 1999), *cert. denied*, 529 U.S. 1038 (2000), in which the Eighth Circuit affirmed the denial of the plaintiffs' motion to amend to add three new named plaintiffs. Holding the plaintiffs to the good cause standard under Rule 16, the Eighth Circuit concluded that Plaintiffs failed to satisfy that standard. The court stated that dismissal of the first amended complaint should have alerted plaintiffs to their named plaintiffs' inadequacies. *Id.* In addition, the court noted that plaintiffs did not move to amend to add new named plaintiffs until after the defendants responded to a motion for class certification. Granting plaintiffs' motion would have required reopening class discovery and further delay—the very sort of prejudice justifying denial of a motion to amend. *Id.*

1. Substitution of Named Plaintiff

As to Plaintiffs' motion to amend to dismiss Mrs. Gallus as a named plaintiff and substitute Diana J. Anderson, Defendants argue that Plaintiffs have long been aware that Mrs. Gallus did not wish to participate in this litigation. Defendants cite to a November 3, 2005 newspaper advertisement appearing in the International

Falls Daily Journal that solicited a person owning an AXP Large Cap Equity Fund to contact Plaintiffs' counsel, Chestnut & Cambronne. (Ex. 2 to Defs.' Mem. in Opp'n Pls' Mot. to Am.)

Plaintiffs, however, contend that Mrs. Gallus has been participating in this litigation since it was filed, but only recently has become anxious and fearful of the legal process. Plaintiffs have proposed a new plaintiff, Ms. Anderson, who is willing to step in. Ms. Anderson owned shares of the AXP Blue Chip Advantage Fund at the time the original Complaint was filed and continues to own shares of the AXP Large Cap Equity, Fund, the successor in interest to the AXP Blue Chip Advantage Fund. On June 25, 2004, the AXP Blue Chip Advantage Fund merged into the AXP Large Cap Equity Fund, which is the fund Ms. Anderson now owns. Ms. Anderson has been a security holder of the AXP Large Cap Equity Fund, and previously, the AXP Blue Chip Advantage Fund, for the same relevant period as Mrs. Gallus and she has the same claims as Mrs. Gallus on behalf of the fund. (*See* Pls.' Mem. Supp. Mot. Am. at 2-3.)

In addition, Ms. Anderson owns shares of AXP Mutual Fund and formerly owned shares of the AXP New Dimensions Fund. She owned shares in both funds since the original Complaint was filed as well as the year prior to the filing of the original Complaint. *Id.* at 3. Plaintiffs note that around March 10, 2006, the RiverSource New Dimensions Fund (formerly the AXP New Dimension Fund) merged with the RiverSource Large Cap Equity Fund, and the Large Cap Equity Fund was the surviving entity. *Id., citing* Paula R. Meyer, *Dear Fellow Shareholder Letter.* Plaintiffs state that these funds are already the subject of this action and are owned by Plaintiffs Alexandria Ione Faller and John E. Gallus, respectively. Plaintiffs therefore ask that Ms. Anderson also be permitted to represent the two other funds already in the

case for which she is also a security holder (AXP Mutual Fund and the former AXP New Dimensions Fund). (Pls.' Mem. Supp. Mot. Am. at 4.)

Plaintiffs have demonstrated good cause. Although Defendants point to the newspaper advertisement, that alone is not enough evidence that Plaintiffs have long been trolling for a new named Plaintiff: knowing that Mrs. Gallus had no intention of remaining in the suit. Unlike *Milk Products*, where the dismissal of the first amended complaint should have alerted plaintiffs to their named plaintiffs' inadequacies, there was such action here. If anything, the fact that Plaintiffs did not attempt to substitute Mrs. Gallus in April 2005, when they filed a Corrected Complaint, indicates that Mrs. Gallus wished to remain in the case at that time. The proposed amendment to substitute Ms. Anderson for Mrs. Gallus is not designed to circumvent discovery, nor is it intended to cause delay. Moreover, as the claims in the case remain the same, Defendants are not prejudiced by this amendment. For all of these reasons, Plaintiffs' motion to amend to dismiss Mrs. Gallus and substitute Mrs. Anderson as a named Plaintiff is granted.

2. Proposed Changes and Deletions

Plaintiffs also seek leave to amend to delete certain allegations and to revise the Corrected Complaint in light of name changes and corporate restructuring. Defendants do not oppose the ministerial changes, but oppose Plaintiffs' motion as it relates to the deletion of certain allegations.

a. Name Changes

Plaintiffs' propose to amend the Corrected Complaint to reflect changes that occurred in Defendants' corporate structure on or about September 30, 2005. At that time, the AXP Funds became known as the RiverSource Funds and American Express Financial Corporation be-

came known as Ameriprise Financial, Inc., which is no longer owned by American Express Company. (*See* Pls.' Mem. Supp. Mot. Am. at 6.)

Also at that time, the contracts pursuant to which American Express Financial Corporation provided investment management services to the AXP Funds were transferred or otherwise assigned by American Express Financial Corporation, now known as Ameriprise Financial, Inc., to RiverSource Investments, LLC, a wholly-owned subsidiary of Ameriprise Financial, Inc. As the new investment advisor to the RiverSource Funds, RiverSource Investments, LLC now provides investment management services to the RiverSource Funds. Plaintiffs contend that their damages claims began one year before the filing of the Complaint and continue up to, and including, the date of trial. Therefore, they argue, it is necessary to join RiverSource Investment, LLC as a Defendant as it relates to advisory fees charged and received by that entity for the period beginning on or about September 30, 2005 up to, and including, the date of trial. *Id.* at 7. In addition to making these changes in the body of the Complaint, Plaintiffs seek leave to amend to modify the case caption accordingly. *Id.* at 10.

In satisfaction of the good cause standard, Plaintiffs note that these name changes did not occur until September 30, 2005, long after the April 15, 2005 deadline to move to amend. Moreover, Plaintiffs contend that they were unaware of these name[ ] changes until depositions commenced in early January 2006. *Id.* at 10.

Defendants do not object to the proposed modifications relating to recent name and structural changes, to the extent a formal amendment is required. (Defs.' Mem. in Opp'n to Pls.' Mot. to Am. at 3, n. 1.)

As there is no objection from Defendants to the proposed name change amendments and there is good cause

for allowing them, the Court grants Plaintiffs' motion as it relates to amendments reflecting changes in names and corporate structure.

b. Deletion of Certain Allegations

In his March 7, 2005 Opinion and Order, Judge Frank ruled on Defendants' Motion to Dismiss, stating that the factual assertions presented in the Complaint survived dismissal "only by the narrowest of margins." (3/7/05 Order at 7-8.)

> Specifically, the Court questions whether Plaintiffs have even a good faith basis for their allegations that: (1) AEFC employs "inaccurate accounting practices"; (2) AEFC accepts "kickbacks" from third parties; and (3) AEFC provided "virtually no information to the directors" of the Funds.

Id. at 8.

To allay his concerns about the basis and veracity of the allegations, Judge Frank ordered a limited phase of initial discovery, after which time Defendants could renew their challenge to the complaint, if the discovery so warranted. *Id.*

Although their memorandum fails to identify and discuss the proposed deleted claims in any detail, Plaintiffs seek to delete certain claims that Judge Frank considered questionable, namely, that Defendants employed "inaccurate accounting practices" and received "kickbacks." (*cf.* Corrected Complaint at ¶ 45 with Am. Complaint at ¶ 49; Corrected Complaint at ¶ 58 with Am. Complaint, Ex. 3 to Defs.' Mem. in Opp'n to Pls.' Mot. to Am.) In addition, Plaintiffs also propose different language with respect to claims that Defendants provided "virtually no information" to the directors of the Funds, and now allege that Defendants provided "incomplete and/or misleading information." (*cf.* Corrected Complaint at ¶ 66 with Am. Complaint at ¶ 68.)

In addition to the primary deletions in dispute, noted above, Plaintiffs seek to eliminate the following allegations made on "information and belief:"

> *Compare* Corrected Complaint at ¶¶ 43-44 *with* Amended Complaint (deleted: "Defendants repeatedly put their own financial interests ahead of the interests of the Funds and the shareholders by participating in arrangements and schemes that benefit Defendants at the expense of the Funds and the shareholders of the Funds.;) *compare* Corrected Complaint ¶ 57 *with* Amended Complaint ¶ 59 (deleted: "[T]he soft dollar arrangements are concealed from the shareholders of the Funds in breach of Defendants' fiduciary duty."); *compare* Corrected Complaint ¶ 66 *with* Amended Complaint ¶ 67 (deleted: "the directors failed to insist upon adequate information"; "the directors rarely, if ever, question any information or recommendations provided by Defendants"). Plaintiffs have also eliminated certain allegations with respect to economies of scale and comparative fee structures that were based on the "Freeman and Brown Study." *Compare* Corrected Complaint at ¶¶ 48-53 with Amended Complaint at ¶¶ 52-56.

(Defs.' Mem. in Opp'n to Pls.' Mot. to Am. at 9, n.6.)

Two issues are before the Court, requiring a determination of: (1) whether specific claims identified as questionable by Judge Frank remain in the Amended Complaint, even after certain language is deleted; and (2) whether the Court should impose certain conditions upon Plaintiffs if their Motion to Amend is granted.

The Court first addresses the proposed deletions. Plaintiffs clearly seek to delete references to "kickbacks" in their allegations. *Cf.* Corrected Complaint at ¶ 58 with Am. Complaint. In dispute, however, is whether the pro-

posed deletions remove allegations concerning cost allocation procedures and profitability analyses. *See* Corrected Complaint at § 45 and Am. Complaint at § 49. Defendants contend that the proposed language says the same thing as the original language and if removed from the case, eliminates the need for related discovery. Plaintiffs, on the other hand, argue that cost allocation procedures and profitability analyses remain at issue, and that Plaintiffs are entitled to discovery.

The disputed language concerning profitability is found in Corrected Complaint § 45 and Amended Complaint § 49:

> The profitability of a fund to an adviser-manager is a function of revenues minus the costs of providing services. However, upon information and belief, Defendants' reporting of their revenue and costs is intended to, and does, obfuscate Defendants' true profitability. ~~For instance, upon information and belief, Defendants employ inaccurate accounting practices in their financial reporting, including arbitration and unreasonable cost allocation.~~

Plaintiffs contend that Defendants' profitability reports have revealed changes in how costs are allocated, but Defendants have provided no historical continuity for their cost allocation methodology. One basis for Plaintiffs' allegations comes from deposition testimony, including that of financial analyst Timothy Armbrustmacher. Plaintiffs contend that his testimony supports their allegation that Defendants' accounting practices with respect to cost allocation are inappropriate. Plaintiffs argue that they are entitled to develop their case with respect to their cost allocation and profitability allegations.

On this motion to amend, Plaintiffs have sufficiently pled the claim found in Amended Complaint § 49. It may be that further discovery fails to shore up this claim, in

which case, Defendants will address it in summary judgment motions. As to satisfying the good cause standard, Judge Frank permitted the parties to gather limited discovery on certain allegations that were of concern. Plaintiffs have deposed persons on the issue of cost allocations and profitability, including Mr. Armbrustmacher, whose deposition took place on March 24, 2006. Plaintiffs do not appear to have been dilatory in moving to amend these particular allegations.

However, as Defendants note, courts have broad discretion in the management of cases, including the authority to impose conditions on parties seeking relief. *See, e.g., Wisland v. Admiral Beverage Corp.*, 119 F.3d 733, 737 (8th Cir. 1997) ("The rules give wide authority and discretion to the district court to manage its caseload."); *United States v. Smith*, 422 F.3d 715, 725-26 (8th Cir. 2005); *Davidson v. Allis-Chalmers Corp.*, 567 F.Supp. 1532, 1547-48 (W.D. Mo. 1983) (requiring plaintiffs to pay additional discovery costs in conditional grant of motion for leave to amend the complaint); *American Infra-Red Radiant Co. v. Lambert Indus., Inc.*, 32 F.R.D. 372, 375 (D. Minn. 1963) (conditioning plaintiffs motion to amend complaint on granting defendant a continuance).

The Court agrees with Defendants that, as to the deleted allegations, Plaintiffs are prohibited from presenting at trial any evidence relating to the deleted allegations. Allegations concerning cost allocation procedures and profitability analyses remain in the case, however, so to the extent that Plaintiffs' discovery requests address these allegations, Defendants should respond accordingly.

Plaintiffs, however, are required to respond to Defendants' discovery requests regarding the bases for including the deleted allegations in the complaint The Court acknowledges that Plaintiffs have taken responsibility to delete unsupported allegations and to resolve

problems in the Corrected Complaint. Nevertheless, Defendants are entitled to information regarding the deleted claims. Accordingly, Plaintiffs' motion to amend is granted, subject to the conditions set forth above.

B. Motion to Compel

The Second Amended Pretrial Scheduling Order contemplated discovery in two phases. (*See* Second Am. Pretrial Scheduling Order of 2/3/06 at 1, Doc. No. 102.) During Phase I, the parties were directed to engage in discovery and motion practice related to two funds selected by Plaintiffs. Phase I factual discovery was to be completed by April 3, 2006. *Id.* at 3.

Plaintiffs filed the instant motion to compel on February 24, 2006. Plaintiffs move the Court for an Order as follows: (1) ordering the production of discovery materials that post-date June 9, 2004, the date the Complaint was filed; (2) finding that all 30(b)(6) depositions count as one deposition; and (3) the designation of a witness pursuant to "Topic 7" of Schedule A of Plaintiffs' Rule 30(b)(6) Notice.

1. Discovery Cut-Off Date

Defendants have objected to the production of any discovery that post-dates June 9, 2004, arguing that such discovery is irrelevant because the ICA, 15 U.S.C. § 80a-35(b)(3), provides for a one-year damages period. Moreover, Defendants argue that the production of such discovery would be unduly burdensome, noting that they have been served with three separate sets of document requests, totaling 91 separate categories of documents. They contend that they have produced over 430,000 pages of documents in response to Plaintiffs' requests. (*See* Defs.' Mem. in Opp'n to Pls.' Mot. Compel at 6.)

Plaintiffs argue that they should be permitted to discover such information because it will provide context to the case and support their theory of liability and dam-

ages. Plaintiffs assert that, in general, damages typically run until the time of trial, particularly where a continuing wrong is alleged. In addition, Plaintiffs disagree with Defendants' argument regarding the burdensomeness of the discovery. Of the 430,000 documents Defendants have produced, Plaintiffs contend that only 220,000 pages are under actual review. Plaintiffs argue that this is because 200,000 pages consisted of irrelevant equity analyst reports and 10,000 pages were unusable, poorly formatted pages. Therefore, Plaintiffs disagree with Defendants' characterization of the scope of discovery to date.

The ICA provides for breach of fiduciary duty claims against investment companies. *See* U.S.C. § 80a-35. Under the ICA, "No award of damages shall be recoverable for any period prior to one year before the action was instituted." ICA § 36(b), 15 U.S.C. § 80a-35. Although the Eighth Circuit has not construed this provision, other courts, including the Supreme Court, have interpreted it to mean that recovery for damages is limited to the one-year period prior to the filing of the complaint. *See Daily Income Fund. Inc. v. Fox*, 464 U.S. 523, 526 n.2 (1984) ("recovery is limited to actual damages for a period of one year prior to suit. § 80a-35(b)(3)"); *Green v. Nuveen Advisory Corp.*, 295 F.3d 738, 743 (7th Cir. 2002) ("Congress enacted § 36(b) to provide a narrow federal remedy that 'is significantly more circumscribed than common law fiduciary duty doctrines.' For example, . . . damages are recoverable only for the one-year period before the filing of the action."), *cert. denied*, 537 U.S. 1088 (2002); *Fox v. Reich & Tang. Inc.*, 692 F.2d 250, 261 (2d Cir. 1982) ("Section 36(b) expressly limits recovery to excessive fees paid up to one year prior to the commencement of suit."). In a recent related case in the Northern District of Illinois, the district court ruled that damages were recoverable only for the one-year period before the filing of the action.

The court stated that "if the statute circumscribes damages and limits it, then any discovery beyond what the statute would afford would not be relevant." ((Hearing Transcript, *Jones v. Harris Assocs. LP*, No. 04-8305 (N.D. Ill. Dec. 19, 2005), Ex. 1 to Defs.' Mem. Opp'n to Mot. Compel.))

The Court agrees with Defendants that *Krasner v. Dreyfus Corp.*, 500 F. Supp. 36 (S.D.N.Y. 1980) (in ruling on a privately negotiated settlement agreement involving several different actions filed over a number of years, the court looked forward in approving the settlement amount), is distinguishable for the reasons cited by Defendants, e.g., different actions filed over the course of several years complicated the determination of the one-year look back period, and it was decided prior to the decisions cited above—including a United States Supreme Court decision.

As other courts have determined, under the ICA, damages are limited to the one-year period before the filing of the action. Therefore, to the extent that Plaintiffs' discovery requests relate to post-Complaint *damages*, they are not relevant and Defendants need not respond. In addition, Plaintiffs have moved to compel at the end of Phase I of discovery, after having taken fourteen depositions. Plaintiffs could have made their motion earlier. Because the scope of the damages discovery is so broad, compliance with Plaintiffs' requests would be burdensome for Defendants, regardless of how one characterizes Defendants' production to date.

On the issue of *liability*, however, Plaintiffs argue that after this case was filed, Defendants continued to engage in inappropriate activity. Although the ICA circumscribes the damages period, it does not address liability in any other provision. Because post-Complaint liability discovery could arguably lead to the discovery of admissible evidence, the Court orders the parties to meet and

confer regarding post-Complaint liability discovery within 10 days. Defendants note that they have agreed to produce post-complaint documents on specified topics. (Mem. in Opp'n to Pls.' Mot. to Compel at 7.) To the extent that there are identifiable categories of such discovery, the parties should address which documents are truly needed and produce them within 10 days following the parties' conference.

2. Number of 30(b)(6) Depositions and "Topic 7" Testimony

The Scheduling Order provides that each side may take no more than 15 fact depositions. (Second Am. Pretrial Scheduling Order at 4, Doc. No. 102.) Plaintiffs seek a determination that all 30(b)(6) depositions that have occurred to date count as one deposition. At the hearing on this motion, the parties stated that the 30(b)(6) depositions had consumed approximately 30 hours of deposition time. At the time of the hearing, Plaintiffs had taken 14 depositions. Defendants oppose the motion, arguing that four depositions of company employees produced pursuant to one 30(b)(6) notice, and the deponents produced pursuant to three distinct 30(b)(6) notices, cannot be considered to be one deposition.

Rather than parsing out whether certain deponents testified in their individual capacities and/or as 30(b)(6) witnesses, the Court resolves this dispute by referring to the Scheduling Order itself. The Scheduling Order contemplates no more than 15, seven-hour depositions.[1] The Order therefore provides for a total of 105 hours of deposition time (15 depositions x 7 hours). Plaintiffs have

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[1] Although the Scheduling Order does not specify the seven-hour limit for each deposition, seven hours is the standard length of a deposition and is a standard used by the Court in reaching its determination here.

used 30 hours of deposition time in 30(b)(6) depositions and have taken eight other depositions. Again, assuming that the eight other depositions were each seven-hours long, Plaintiffs consumed 56 hours of deposition time (8 depositions x 7 hours). Adding 30 hours of 30(b)(6) time, to 56 hours of individual deposition time, the Court arrives at 86 hours of deposition time consumed by Plaintiffs. Subtracting 86 hours from the total allotment of 105 hours, leaves 19 hours of deposition time. Plaintiffs, therefore, may utilize 19 more hours of deposition time.

Plaintiffs specifically seek additional 30(b)(6) testimony on "Topic 7" of their 30(b)(6) notice, which essentially concerned Defendants' financial status. Defendants designated Douglas Roderick as their 30(b)(6) representative on this topic. Plaintiffs contend that at his January 16, 2006 deposition, Mr. Roderick testified that he did not have knowledge concerning several aspects of Defendants' revenues or expenses as they were reported to the Board of Directors of the RiverSource Funds. (*See* Pls.' Mem. Supp. Mot. Compel at 5.)

Defendants assert that Plaintiffs original eight-topic 30(b)(6) notice was remarkably broad. (Defs.' Mem. in Opp'n to Pls.' Mot. to Compel at 11.) Defendants note that Plaintiffs sent a "revised" version of their original notice on March 20, 2006, as well as a new four-topic 30(b)(6) notice. In response, Defendants produced four employees involved in the negotiation of fees with the Funds' Board—the employees named in Ameriprise's Rule 26(a) disclosures. *Id.* At the deposition, Defendants contend that Plaintiffs' questions far exceeded the scope of the 30(b)(6) notice. Accordingly, Defendants objected to certain questions as going beyond the scope of the 30(b)(6) notice, but permitted each witness to answer in his or her individual capacity. Defendants also argue that Plaintiffs' motion should be denied as moot, asserting that they produced a witness for deposition on March

24, 2006, who covered every topic in the expanded "Topic 7."

Defendants are credited for having already produced four "Topic 7" witnesses. Despite their efforts, however, Plaintiffs believe they have not gotten complete testimony on "Topic 7." Defendants, therefore, are to produce one more witness. Of Plaintiffs' remaining 19 hours of deposition time, this "Topic 7" witness may be deposed for no more than four hours. Plaintiffs are to create a list of specific, narrow topics to be addressed by this remaining witness, totaling no more than five topics. The parties are to meet and confer on the topic areas, if necessary.

C. Motion to Quash and for Protective Order

Plaintiffs seek a motion to quash the subpoena for Mrs. Gallus's deposition and for a protective order barring her deposition. As the Court has found, *infra*, Mrs. Gallus may be dismissed from the case and Mrs. Anderson may be added as a substitute Plaintiff. Not only is Mrs. Gallus not a party to the litigation by virtue of this ruling, Defendants have other sources from which to get the information they seek.

Plaintiffs aver that the information that Mrs. Gallus might provide can be likewise obtained from the deposition of her husband, Mr. Gallus, who remains in the litigation, or from the depositions of Mrs. Anderson, the substitute plaintiff, and/or Plaintiff Alexandria Ione Faller. In addition, Plaintiffs suggest that they could provide a stipulation regarding Mrs. Gallus's knowledge, in lieu of her being deposed.

Consistent with the Court's ruling that Mrs. Gallus be dismissed as a plaintiff, the Court grants Plaintiffs' motion to quash so that Mrs. Gallus may not be deposed. In lieu of Mrs. Gallus's deposition, however, Defendants are entitled to the following discovery: (1) Defendants may

serve interrogatories on Mrs. Gallus, though no more than 12 interrogatories in total; and (2) Defendants may inquire about the extent of Mrs. Gallus's knowledge at her husband's deposition and Mr. Gallus must be prepared to testify accordingly. Plaintiffs' motion is thus granted, in part, and denied, in part.

THEREFORE, IT IS HEREBY ORDERED THAT:

A. Plaintiffs' Motion to Compel Discovery (Doc. No. 105) is **GRANTED, in part, and DENIED, in part**;

B. Plaintiff's Motion to Amend/Correct the Complaint (Doc. No. 108) is **GRANTED**, subject to the conditions set forth in this Order;

C. Plaintiff's Motion to Quash a Subpoena and for a Protective Order (Doc. No. 111) is **GRANTED, in part, and DENIED, in part**.

Dated: May 30, 2006

s/Susan Richard Nelson
SUSAN RICHARD NELSON
United States Magistrate Judge

APPENDIX F

RELEVANT STATUTORY PROVISIONS

The Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, provides in relevant part as follows:

§ 80a-2. Definitions; applicability; rulemaking considerations

(a) Definitions

When used in this subchapter, unless the context otherwise requires—

* * *

(19) "Interested person" of another person means—

(A) when used with respect to an investment company—

(i) any affiliated person of such company,

(ii) any member of the immediate family of any natural person who is an affiliated person of such company,

(iii) any interested person of any investment adviser of or principal underwriter for such company,

(iv) any person or partner or employee of any person who at anytime since the beginning of the last two completed fiscal years of such company has acted as legal counsel for such company,

(v) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has executed any portfolio transactions for, engaged in any principal transactions with, or distributed shares for—

(I) the investment company;

(II) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(III) any account over which the investment company's investment adviser has brokerage placement discretion,

(vi) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has loaned money or other property to—

(I) the investment company;

(II) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(III) any account for which the investment company's investment adviser has borrowing authority,[1]

(vii) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had, at any time since the beginning of the last two completed fiscal years of such company, a material business or professional relationship with such company or with the principal executive officer of such company or with any other investment company having the same

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[1] So in original. Probably should be followed by the word "and".

investment adviser or principal underwriter or with the principal executive officer of such other investment company: *Provided*, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the immediate family of any person specified in clause (aa) of this proviso; and

(B) when used with respect to an investment adviser of or principal underwriter for any investment company—

(i) any affiliated person of such investment adviser or principal underwriter,

(ii) any member of the immediate family of any natural person who is an affiliated person of such investment adviser or principal underwriter,

(iii) any person who knowingly has any direct or indirect beneficial interest in, or who is designated as trustee, executor, or guardian of any legal interest in, any security issued either by such investment adviser of principal underwriter or by a controlling person or such investment adviser or principal underwriter,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two completed fiscal years of such investment company has acted as legal counsel for such investment adviser or principal underwriter,

(v) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has executed any portfolio transactions for, en-

gaged in any principal transactions with, or distributed shares for—

(I) any investment company for which the investment adviser or principal underwriter serves as such;

(II) any investment company holding itself out to investors, for purposes of investment or investor services, as a company related to any investment company for which the investment adviser or principal underwriter serves as such; or

(III) any account over which the investment adviser has brokerage placement discretion,

(vi) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has loaned money or other property to—

(I) any investment company for which the investment adviser or principal underwriter serves as such;

(II) any investment company holding itself out to investors, for purposes of investment or investor services, as a company related to any investment company for which the investment adviser or principal underwriter serves as such; or

(III) any account for which the investment adviser has borrowing authority,[2]

(vii) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had at any time since

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[2] So in original. Probably should be followed by the word "and".

the beginning of the last two completed fiscal years of such investment company a material business or professional relationship with such investment adviser or principal underwriter or with the principal executive officer or any controlling person of such investment adviser or principal underwriter.

For the purposes of this paragraph (19), "member of the immediate family" means any parent, spouse of a parent, child, spouse of a child, spouse, brother, or sister, and includes step and adoptive relationships. The Commission may modify or revoke any order issued under clause (vi) of subparagraph (A) or (B) of this paragraph whenever it finds that such order is no longer consistent with the facts. No order issued pursuant to clause (vi) of subparagraph (A) or (B) of this paragraph shall become effective until at least sixty days after the entry thereof, and no such order shall affect the status of any person for the purposes of this subchapter or for any other purpose for any period prior to the effective date of such order.

* * *

§ 80a-10. Affiliations or interest of directors, officers, and employees

(a) Interested persons of company who may serve on board of directors

No registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company.

(b) Employment and use of directors, officers, etc., as regular broker, principal underwriter, or investment banker

No registered investment company shall—

(1) employ as regular broker any director, officer, or employee of such registered company, or any person of which any such director, officer, or employee is an affiliated person, unless a majority of the board of directors of such registered company shall be persons who are not such brokers or affiliated persons of any of such brokers;

(2) use as a principal underwriter of securities issued by it any director, officer, or employee of such registered company or any person of which any such director, officer, or employee is an interested person, unless a majority of the board of directors of such registered company shall be persons who are not such principal underwriters or interested persons of any of such principal underwriters; or

(3) have as director, officer, or employee any investment banker, or any affiliated person of an investment banker, unless a majority of the board of directors of such registered company shall be persons who are not investment bankers or affiliated persons of any investment banker. For the purposes of this paragraph, a person shall not be deemed an affiliated person of an investment banker solely by reason of the fact that he

is an affiliated person of a company of the character described in section 80a-12(d)(3)(A) and (B) of this title.

(c) Officers, directors, or employees of one bank or bank holding company as majority of board of directors of company; exceptions

No registered investment company shall have a majority of its board of directors consisting of persons who are officers, directors, or employees of any one bank (together with its affiliates and subsidiaries) or any one bank holding company (together with its affiliates and subsidiaries) (as such terms are defined in section 1841 of title 12) or any one savings and loan holding company, together with its affiliates and subsidiaries (as such terms are defined in section 1467a of title 12), except that, if on March 15, 1940, any registered investment company had a majority of its directors consisting of persons who are directors, officers, or employees of any one bank, such company may continue to have the same percentage of its board of directors consisting of persons who are directors, officers, or employees of such bank.

(d) Exception to limitation of number of interested persons who may serve on board of directors

Notwithstanding subsections (a) and (b)(2) of this section, a registered investment company may have a board of directors all the members of which, except one, are interested persons of the investment adviser of such company, or are officers or employees of such company, if—

(1) such investment company is an open-end company;

(2) such investment adviser is registered under subchapter II of this chapter and is engaged principally in the business of rendering investment supervisory services as defined in subchapter II;

(3) no sales load is charged on securities issued by such investment company;

(4) any premium over net asset value charged by such company upon the issuance of any such security, plus any discount from net asset value charged on redemption thereof, shall not in the aggregate exceed 2 per centum;

(5) no sales or promotion expenses are incurred by such registered company; but expenses incurred in complying with laws regulating the issue or sale of securities shall not be deemed sales or promotion expenses;

(6) such investment adviser is the only investment adviser to such investment company, and such investment adviser does not receive a management fee exceeding 1 per centum per annum of the value of such company's net assets averaged over the year or taken as of a definite date or dates within the year;

(7) all executive salaries and executive expenses and office rent of such investment company are paid by such investment adviser; and

(8) such investment company has only one class of securities outstanding, each unit of which has equal voting rights with every other unit.

(e) Death, disqualification, or resignation of directors as suspension of limitation provisions

If by reason of the death, disqualification, or bona fide resignation of any director or directors, the requirements of the foregoing provisions of this section or of section 80a-15(f)(1) of this title in respect of directors shall not be met by a registered investment company, the operation of such provision shall be suspended as to such registered company—

(1) for a period of thirty days if the vacancy or vacancies may be filled by action of the board of directors;

(2) for a period of sixty days if a vote of stockholders is required to fill the vacancy or vacancies; or

(3) for such longer period as the Commission may prescribe, by rules and regulations upon its own motion or by order upon application, as not inconsistent with the protection of investors.

(f) Officer, director, etc., of company acting as principal underwriter of security acquired by company

No registered investment company shall knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security (except a security of which such company is the issuer) a principal underwriter of which is an officer, director, member of an advisory board, investment adviser, or employee of such registered company, or is a person (other than a company of the character described in section 80a-12(d)(3)(A) and (B) of this title) of which any such officer, director, member of an advisory board, investment adviser, or employee is an affiliated person, unless in acquiring such security such registered company is itself acting as a principal underwriter for the issuer. The Commission, by rules and regulations upon its own motion or by order upon application, may conditionally or unconditionally exempt any transaction or classes of transactions from any of the provisions of this subsection, if and to the extent that such exemption is consistent with the protection of investors.

(g) Advisory boards; restrictions on membership

In the case of a registered investment company which has an advisory board, such board, as a distinct entity, shall be subject to the same restrictions as to its mem-

bership as are imposed upon a board of directors by this section.

(h) Application of section to unincorporated registered management companies

In the case of a registered management company which is an unincorporated company not having a board of directors, the provisions of this section shall apply as follows:

(1) the provisions of subsection (a) of this section, as modified by subsection (e) of this section, shall apply to the board of directors of the depositor of such company;

(2) the provisions of subsections (b) and (c) of this section, as modified by subsection (e) of this section, shall apply to the board of directors of the depositor and of every investment adviser of such company; and

(3) the provisions of subsection (f) of this section shall apply to purchases and other acquisitions for the account of such company of securities a principal underwriter of which is the depositor or an investment adviser of such company, or an affiliated person of such depositor or investment adviser.

* * *

§ 80a-15. Contracts of advisers and underwriters

(a) Written contract to serve or act as investment adviser; contents

It shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company, and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment.

(b) Written contract with company for sale by principal underwriter of security of which company is issuer; contents

It shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment.

(c) Approval of contract to undertake service as investment adviser or principal underwriter by majority of noninterested directors

In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval. It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company. It shall be unlawful for the directors of a registered investment company, in connection with their evaluation of the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company, to take into account the purchase price or other consideration any person may have paid in

connection with a transaction of the type referred to in paragraph (1), (3), or (4) of subsection (f) of this section.

(d) Equivalent of vote of majority of outstanding voting securities in case of common-law trust

In the case of a common-law trust of the character described in section 80a-16(c) of this title, either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (42) of section 80a-2(a) of this title as to a majority shall be applicable to the vote cast at such a meeting.

(e) Exemption of advisory boards or members from provisions of this section

Nothing contained in this section shall be deemed to require or contemplate any action by an advisory board of any registered company or by any of the members of such a board.

(f) Receipt of benefits by investment adviser from sale of securities or other interest in such investment adviser resulting in assignment of investment advisory contract

(1) An investment adviser, or a corporate trustee performing the functions of an investment adviser, of a registered investment company or an affiliated person of such investment adviser or corporate trustee may receive any amount or benefit in connection with a sale of securities of, or a sale of any other interest in, such investment adviser or corporate trustee which results in an assignment of an investment advisory contract with such company or the change in control of or identity of such corporate trustee, if—

(A) for a period of three years after the time of such action, at least 75 per centum of the members of the board of directors of such registered company or such corporate trustee (or successor thereto, by reorganization or otherwise) are not (i) interested persons of the investment adviser of such company or such corporate trustee, or (ii) interested persons of the predecessor investment adviser or such corporate trustee; and

(B) there is not imposed an unfair burden on such company as a result of such transaction or any express or implied terms, conditions, or understandings applicable thereto.

(2)(A) For the purpose of paragraph (l)(A) of this subsection, interested persons of a corporate trustee shall be determined in accordance with section 80a-2(a)(19)(B) of this title: *Provided*, That no person shall be deemed to be an interested person of a corporate trustee solely by reason of (i) his being a member of its board of directors or advisory board or (ii) his membership in the immediate family of any person specified in clause (i) of this subparagraph.

(B) For the purpose of paragraph (1)(B) of this subsection, an unfair burden on a registered investment company includes any arrangement, during the two-year period after the date on which any such transaction occurs, whereby the investment adviser or corporate trustee or predecessor or successor investment advisers or corporate trustee or any interested person of any such adviser or any such corporate trustee receives or is entitled to receive any compensation directly or indirectly (i) from any person in connection with the purchase or sale of securities or other property to, from, or on behalf of such company, other than bona fide ordinary compensation as principal underwriter for such company, or (ii) from such company or

its security holders for other than bona fide investment advisory or other services.

(3) If—

(A) an assignment of an investment advisory contract with a registered investment company results in a successor investment adviser to such company, or if there is a change in control of or identity of a corporate trustee of a registered investment company, and such adviser or trustee is then an investment adviser or corporate trustee with respect to other assets substantially greater in amount than the amount of assets of such company, or

(B) as a result of a merger of, or a sale of substantially all the assets by, a registered investment company with or to another registered investment company with assets substantially greater in amount, a transaction occurs which would be subject to paragraph (1)(A) of this subsection, such discrepancy in size of assets shall be considered by the Commission in determining whether or to what extent an application under section 80a-6(c) of this title for exemption from the provisions of paragraph (l)(A) of this subsection should be granted.

(4) Paragraph (l)(A) of this subsection shall not apply to a transaction in which a controlling block of outstanding voting securities of an investment adviser to a registered investment company or of a corporate trustee performing the functions of an investment adviser to a registered investment company is—

(A) distributed to the public and in which there is, in fact, no change in the identity of the persons who control such investment adviser or corporate trustee, or

(B) transferred to the investment adviser or the corporate trustee, or an affiliated person or persons

of such investment adviser or corporate trustee, or is transferred from the investment adviser or corporate trustee to an affiliated person or persons of the investment adviser or corporate trustee: *Provided*, That (i) each transferee (other than such adviser or trustee) is a natural person and (ii) the transferees (other than such adviser or trustee) owned in the aggregate more than 25 per centum of such voting securities for a period of at least six months prior to such transfer.

* * *

§ 80a-33. Destruction and falsification of reports and records

(a) Willful destruction

It shall be unlawful for any person, except as permitted by rule, regulation, or order of the Commission, willfully to destroy, mutilate, or alter any account, book, or other document the preservation of which has been required pursuant to section 80a-30(a) or 80a-31(c) of this title.

(b) Untrue statements or omissions

It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter or the keeping of which is required pursuant to section 80a-30(a) of this title. It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an accountant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document.

* * *

§ 80a-35. Breach of fiduciary duty

(a) Civil actions by Commission; jurisdiction; allegations; injunctive or other relief

The Commission is authorized to bring an action in the proper district court of the United States, or in the United States court of any territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has engaged within five years of the commencement of the action or is about to engage in any act or practice constituting a breach of fiduciary duty involving personal misconduct in respect of any registered investment company for which such person so serves or acts—

(1) as officer, director, member of any advisory board, investment adviser, or depositor; or

(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If such allegations are established, the court may enjoin such persons from acting in any or all such capacities either permanently or temporarily and award such injunctive or other relief against such person as may be reasonable and appropriate in the circumstances, having due regard to the protection of investors and to the effectuation of the policies declared in section 80a-1(b) of this title.

(b) Compensation or payments as basis of fiduciary duty; civil actions by Commission or security holder; burden of proof; judicial consideration of director or shareholder approval; persons liable; extent of liability; exempted transactions; jurisdiction; finding restriction

For the purposes of this subsection, the investment adviser of a registered investment company shall be

deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. With respect to any such action the following provisions shall apply:

(1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

(2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances.

(3) No such action shall be brought or maintained against any person other than the recipient of such compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments. No

award of damages shall be recoverable for any period prior to one year before the action was instituted. Any award of damages against such recipient shall be limited to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payment received from such investment company, or the security holders thereof, by such recipient.

(4) This subsection shall not apply to compensation or payments made in connection with transactions subject to section 80a-17 of this title, or rules, regulations, or orders thereunder, or to sales loads for the acquisition of any security issued by a registered investment company.

(5) Any action pursuant to this subsection may be brought only in an appropriate district court of the United States.

(6) No finding by a court with respect to a breach of fiduciary duty under this subsection shall be made a basis (A) for a finding of a violation of this subchapter for the purposes of sections 80a-9 and 80a-48 of this title, section 78o of this title, or section 80b-3 of this title, or (B) for an injunction to prohibit any person from serving in any of the capacities enumerated in subsection (a) of this section.

(c) Corporate or other trustees performing functions of investment advisers

For the purposes of subsections (a) and (b) of this section, the term "investment adviser" includes a corporate or other trustee performing the functions of an investment adviser.

* * *

APPENDIX G
RELEVANT REGULATORY MATERIALS

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 240, and 274

69 Fed. Reg. 39798 (June 30, 2004)

[Release Nos. 33-8433; 34-49909; IC-26486; File No. S7-08-04]

RIN 3235-AJ10

Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies

AGENCY: Securities and Exchange Commission
ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting rule and form amendments under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 to improve the disclosure provided by registered management investment companies about how their boards of directors evaluate and approve, and recommend shareholder approval of, investment advisory contracts. The amendments require a registered management investment company to provide disclosure in its reports to shareholders regarding the material factors and the conclusions with respect to those factors that formed the basis for the board's approval of advisory contracts during the most recent fiscal half-year. The amendments also are designed to encourage improved disclosure in proxy state-

ments regarding the basis for the board's recommendation that shareholders approve an advisory contract.

DATES: *Effective Date:* August 5, 2004, except that the amendments to Item 12 of Form N-1A,[1] Item 18 of Form N-2,[2] and Item 20 of Form N-3[3] are effective January 31, 2006.

Compliance Date: All fund reports to shareholders for periods ending on or after March 31, 2005, and all fund proxy statements on Schedule 14A filed on or after October 31, 2004, are required to comply with these amendments. Section II.C. of this release contains more information on the compliance date.

FOR FURTHER INFORMATION CONTACT: Deborah D. Skeens, Senior Counsel, or Paul G. Cellupica, Assistant Director, Office of Disclosure Regulation, Division of Investment Management, (202) 942-0721, at the Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting amendments[4] to Schedule 14A,[5] the schedule used by registered investment companies and issuers registered under section 12 of the Securities Exchange Act of 1934 ("Exchange Act")[6] for proxy statements pursuant to section 14(a) of the Exchange Act, and Forms N-1A, N-2, and N-3, registration forms used by management invest-

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[1] 17 CFR 239.15A and 274.11A.

[2] 17 CFR 239.14 and 274.11a-1.

[3] 17 CFR 239.17a and 274.11b.

[4] The Commission proposed these amendments in February 2004. Investment Company Act Release No. 26350 (Feb. 11, 2004) [69 FR 7852 (Feb. 19, 2004)] ("Proposing Release").

[5] 17 CFR 240.14a-101.

[6] 15 U.S.C. 78a *et seq.*

ment companies to register under the Investment Company Act of 1940 ("Investment Company Act")[7] and to offer their securities under the Securities Act of 1933 ("Securities Act").[8]

Table of Contents

I. Background
II. Discussion
A. Disclosure Requirements in Shareholder Reports
B. Disclosure Enhancements
C. Compliance Date
III. Paperwork Reduction Act
IV. Cost/Benefit Analysis
V. Consideration of Burden on Competition; Promotion of Efficiency, Competition, and Capital Formation
VI. Final Regulatory Flexibility Analysis
VII. Statutory Authority
Text of Rule and Form Amendments

I. Background

Unlike most business organizations, registered management investment companies ("funds")[9] are typically

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[7] 15 U.S.C. 80a-1 *et seq.*

[8] 15 U.S.C. 77a *et seq.*

[9] Management investment companies typically issue shares representing an undivided proportionate interest in a changing pool of securities, and include open-end and closed-end companies. *See* T. Lemke, G. Lins, A. Smith III, Regulation of Investment Companies, Vol. I, ch. 4, § 4.04, at 4-5 (2002). An open-end company is a management company that is offering for sale or has outstanding any redeemable securities of which it is the issuer. A closed-end company is any management company other than an open-end company. *See* section 5 of the Investment Company Act [15 U.S.C. 80a-5]. Open-end companies generally offer and sell new shares to the public on a continuous basis. Closed-end companies generally engage in traditional underwritten offerings of a fixed number of shares and, in

organized by an investment adviser that is responsible for the day-to-day operations of the fund. In most cases, the investment adviser is organized as a corporation, whose shareholders may have an interest with respect to the fund that is quite different from the interests of the fund's shareholders. One of the key areas where the interests of fund shareholders and shareholders of the investment adviser diverge is fees. While fund shareholders ordinarily prefer lower fees to achieve greater returns, shareholders of the fund's investment adviser often want to maximize profits through higher fees.

The Investment Company Act relies on fund boards of directors to police conflicts of interest, including conflicts with respect to fees to be received by investment advisers. Section 15(a) makes it unlawful for any person to serve as an investment adviser to a fund, except pursuant to a written contract that has been approved by a majority vote of the fund's shareholders and that continues in effect for not more than two years, unless its continuance is approved at least annually by the board of directors or a majority vote of the shareholders.[10] In addition, section 15(c) requires that the terms of any advisory contract, and any renewal thereof, be approved by a vote of the majority of the disinterested directors.[11] Section 15(c) also requires a fund's directors to request and evaluate, and an investment adviser to a fund to furnish, such information as may reasonably be necessary to evaluate

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most cases, do not offer their shares to the public on a continuous basis.

[10] 15 U.S.C. 80a-15(a).

[11] We refer to directors who are not "interested persons" of the fund as "independent directors" or "disinterested directors." The term "interested person" is defined in section 2(a)(19) [15 U.S.C. 80a-2(a)(19)] of the Investment Company Act.

the terms of any advisory contract.[12] As part of their fiduciary duties with respect to fund fees, boards of directors are required to evaluate the material factors applicable to a decision to approve an investment advisory contract.[13]

Since 1994, we have required fund proxy statements seeking approval of an investment advisory contract to include a discussion of the material factors that form the basis of the fund board's recommendation that shareholders approve the contract.[14] In 2001, we adopted amendments requiring a fund to provide similar disclosure in its Statement of Additional Information ("SAI")[15] regarding the basis for the board's approval of an existing investment advisory contract.[16]

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[12] 15 U.S.C. 80a-15(c).

[13] *See, e.g., Burks v. Lasker*, 441 U.S. 471, 483 (1979) ("Congress consciously chose to address the conflict-of-interest problem through the [Investment Company] Act's independent-directors section."); *Brown v. Bullock*, 194 F. Supp. 207, 235 (S.D.N.Y.) ("By giving the directors the right to extend and to terminate the [investment advisory] contract, the Act necessarily also imposes upon the directors the fiduciary duty to use these powers intelligently, diligently and solely for the interests of the company and its stockholders."), *aff'd*, 294 F.2d 415 (2d Cir. 1961).

[14] Item 22(c)(11) of Schedule 14A. *See* Investment Company Act Release No. 20614 (Oct. 13, 1994) [59 FR 52689 (Oct. 19, 1994)] (adopting amendments to Schedule 14A).

[15] The SAI is part of a fund's registration statement and contains information about a fund in addition to that contained in the prospectus. The SAI is required to be delivered to investors upon request and is available on the Commission's Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR").

[16] Item 12(b)(10) of Form N-1A (registration statement for open-end management investment companies); Item 18.13 of Form N-2 (registration statement for closed-end management investment companies); Item 20(1) of Form N-3 (registration statement for separate accounts organized as management investment companies that offer

Recently, concerns have been raised regarding the adequacy of review of advisory contracts and management fees by fund boards. In particular, the level of fees charged by investment advisers to mutual fund clients, especially in comparison to those charged by the same advisers to pension plans and other institutional clients, has become the subject of debate.[17] In February 2004,

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variable annuity contracts); Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3734, 3744 (Jan. 16, 2001)] (adopting requirement for disclosure in SAI of basis for board's approval of advisory contract).

[17] *See, e.g.*, John P. Freeman and Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 Iowa Journal of Corporation Law 609, 634 (Spring 2001) (arguing that advisory fees charged by investment advisers for equity pension funds are substantially lower than advisory fees charged by investment advisers for equity mutual funds because advisory fees for pension funds are negotiated through arm's-length bargaining); *Special Report: Perils in the Savings Pool—Mutual Funds*, The Economist, Nov. 8, 2003, at 65 (arguing that fund boards tend to "rubber-stamp" their advisers' contracts without question); Testimony of Gary Gensler, *Hearing before the U.S. House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises*, 108th Cong., 1st Sess. (Mar. 12, 2003) (arguing that "mutual fund boards fire their advisers with about the same frequency that race horses fire their jockeys"). *But see* Sean Collins, *The Expenses of Defined Benefit Pension Plans and Mutual Funds*, Investment Company Institute Perspective (Dec. 2003), *available at http://www.ici.org/statements/res/1per09-06.pdf* (contending that the management fees of mutual funds cover a broader array of services than the fees paid by pension funds to external managers, and that mutual funds and pension funds incur similar fees for similar portfolio management services); Richard M. Phillips, *Mutual Fund Independent Directors: A Model for Corporate America?*, Investment Company Institute Perspective, at 7 (Aug. 2003), *available at http://www.ici.org/statements/res/2per09-04.pdf* (arguing that the effectiveness of fund boards should not be mea-

the Commission proposed to require enhanced disclosure regarding the board's basis for approving, or recommending that shareholders approve, investment advisory contracts, in order to encourage fair and reasonable fund fees. Increased transparency with respect to investment advisory contracts, and fees paid for advisory services, will assist investors in making informed choices among funds and encourage fund boards to engage in vigorous and independent oversight of advisory contracts.[18] This proposal was part of a larger series of Commission rulemaking initiatives that have sought to improve disclosure to investors concerning fund fees and charges.[19]

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sured by reference to the frequency with which boards terminate investment advisers).

[18] *See Statement of the Commission Regarding the Enforcement Action Against Alliance Capital Management, L.P.*, SEC Press Release 2003-176 (Dec. 18, 2003) *http://www.sec.gov/news/press/2003-176.htm* (stating Commission's view that the best way to ensure fair and reasonable fees "is a marketplace of vigorous, independent, and diligent mutual fund boards coupled with fully-informed investors who are armed with complete, easy-to-digest disclosure about the fees paid and the services rendered").

[19] Investment Company Act Release No. 26464 (June 7, 2004) [69 FR 33262 (June 14, 2004)] (adopting amendments that require enhanced disclosure regarding breakpoint discounts on front-end sales loads); Investment Company Act Release No. 26372 (Feb. 27, 2004) [69 FR 11244 (Mar. 9, 2004)] (adopting requirements for expense disclosure in fund shareholder reports); Investment Company Act Release No. 26341 (Jan. 29, 2004) [69 FR 6438 (Feb. 10, 2004)] (proposing point-of-sale disclosure and a new confirmation statement for brokers to use when selling fund shares); Investment Company Act Release No. 26313 (Dec. 18, 2003) [68 FR 74820 (Dec. 24, 2003)] (requesting comment on measures to improve disclosure of mutual fund transaction costs); Investment Company Act Release No. 26195 (Sept. 29, 2003) [68 FR 57760 (Oct. 6, 2003)] (adopting amendments requiring investment company advertisements to highlight the availability and importance of information on fees and charges found in the prospectus).

The Commission received 22 comment letters relating to the proposed amendments from investors, participants in the fund industry, and others. The commenters generally supported the Commission's proposals, although some expressed concerns regarding portions of the disclosure requirements or suggested changes. Today, the Commission is adopting these proposed amendments, with modifications to address commenters' concerns.

In addition to the amendments that we are adopting in this release, we are amending the fund recordkeeping rule to require that funds retain copies of the written materials that directors considered in approving an advisory contract. This recordkeeping requirement will facilitate our compliance examiners' review of whether directors are obtaining the necessary information to make an informed assessment of the advisory contract. The release amending the fund recordkeeping rule also includes measures designed to improve the effectiveness of fund boards of directors and enhance their independence in dealing with matters such as the advisory fee.

II. Discussion

A. Disclosure Requirement in Shareholder Reports

The Commission is adopting, substantially as proposed, amendments to Forms N-1A, N-2, and N-3[20] that require fund shareholder reports to discuss, in reasonable detail, the material factors and the conclusions with respect thereto that formed the basis for the board of directors' approval of any investment advisory contract.[21]

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[20] Open-end management investment companies use Form N-1A to register under the Investment Company Act and to offer their shares under the Securities Act. Closed-end management investment companies use Form N-2, and insurance company managed separate accounts that offer variable annuities use Form N-3.

[21] Item 21(d) (6) of Form N-1A; Instruction 6.e. to Item 23 of Form N-2; In- struction 6(v) to Item 27(a) of Form N-3. The amendments

This requirement applies to shareholder reports of open- and closed-end management investment companies and insurance company managed separate accounts that offer variable annuities.

Several commenters, including investor advocacy groups and fund directors, supported the proposed requirement to include disclosure regarding the board's basis for approval of any investment advisory contract in shareholder reports, agreeing with the Commission that shareholder reports are the location where investors are more likely to read and benefit from this disclosure. However, some fund industry commenters objected to inclusion of the proposed disclosure in shareholder reports. These commenters argued that the disclosure could be lengthy, and that adding it to shareholder reports could dilute their effectiveness. In addition, these commenters noted that information in shareholder reports is subject to certification by the fund's principal executive and principal financial officers, and argued that it would be inappropriate to require fund officers to certify disclosure that explains the board's basis for approving an advisory contract.[22]

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to Form N-1A in this release reflect the renumbering of items in amendments that the Commission recently adopted to the requirements for fund shareholder reports, that renumber Item 6 (Management, Organization, and Capital Structure), Item 13 (Management), and Item 22 (Financial Statements) of Form N-1A as Items 5, 12, and 21, respectively. *See* Investment Company Act Release No. 26372, *supra* note 19. These recent amendments also added Item 21(d) to Form N-1A, Instruction 6 to Item 23 to Form N-2, and Instruction 6(v) to Item 27(a) of Form N-3, containing requirements for annual and semi-annual reports to shareholders for each respective registration form.

[22] *See* rule 30a-2(a) under the Investment Company Act (requiring reports filed on Form N-CSR to require certifications in the form specified in Item 11(a)(2) of Form N-CSR); Item 1 of Form N-CSR (requiring copy of report transmitted to shareholders pursuant to

We continue to believe, however, that including disclosure regarding the board's basis for approving an advisory contract in shareholder reports will provide existing fund shareholders with more timely disclosure of the reasons for the board's approval of an investment advisory contract. The visibility of this disclosure, alongside other current information about a fund, such as investment performance and current period dollars and cents expense disclosure,[23] may encourage funds to provide a meaningful explanation of the board's basis for approving an investment advisory contract. This, in turn, may encourage fund boards to consider investment advisory contracts more carefully and investors to consider more carefully the costs and value of the services rendered by the fund's investment adviser.

We believe that it is appropriate to require a fund's principal executive and financial officers to certify the description of the board's evaluation process based on their knowledge.[24] A certifying officer could rely on informa-

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rule 30e-1 under the Investment Company Act); Item 11(a)(2) of Form N-CSR (form of certification).

[23] The Commission recently adopted rules that require open-end management investment companies to include in shareholder reports Management's Discussion of Fund Performance and information regarding the dollar amount of expenses paid by investors on an ongoing basis. *See* Investment Company Act Release No. 26372, *supra* note 19.

[24] *See* Paragraph 2 of the certification of Item 11(a)(2) of Form N-CSR (requiring officer to certify "based on his or her knowledge"). *Cf.* Item 3(a) of Form N-CSR (requiring disclosure of whether a fund's board of directors has determined that it has at least one audit committee financial expert); Item 4(h) of Form N-CSR (requiring disclosure of whether the audit committee of a fund's board has considered whether the provision of non-audit services rendered to the fund's investment adviser and certain related parties that were not pre-approved by the audit committee is compatible with maintaining the principal accountant's independence).

tion contained in the meeting minutes of the board and other information regarding the board's evaluation that is retained as part of the fund's records.[25] In addition, a fund's board could approve the discussion that is to be included in shareholder reports regarding its basis for approving an advisory contract, in order to assist the fund's principal executive and financial officers in meeting their obligations under the certification requirement.

As adopted, the disclosure requirement in fund shareholder reports will apply to any new investment advisory contract or contract renewal, including subadvisory contracts, approved by the board during the most recent fiscal half-year. The proposal would have excluded contracts that were approved by shareholders from the disclosure requirement. We have determined to include these contracts because we agree with commenters that this comprehensive disclosure will better enable shareholders to remain up-to-date on advisory contract approvals, regardless of whether they were involved in the original approval of the contract. We note that directors have the same duty with respect to approval of an advisory contract, whether or not the contract is also approved by shareholders. We have modified the proposed amendments to clarify that a fund is required to provide shareholder reports disclosure only regarding board approvals during the fund's most recent fiscal half-year.[26] Thus, if the board approves a contract during the first

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[25] *See* rule 31a-1(b)(4) under the Investment Company Act [17 CFR 270.31a-1(b)(4)] (requiring funds to maintain minute books of directors' or trustees' meetings). The Commission is publishing a release adopting amendments to rule 31a-2, the fund recordkeeping rule, that require that a fund retain any written information considered by the directors in approving the terms or renewal of a contract between the fund and an investment adviser.

[26] Item 21(d)(6) of Form N-1A; Instruction 6.e. to Item 23 of Form N-2; Instruction 6(v) to Item 27(a) of Form N-3.

half of a fiscal year, the disclosure would be required in the semi-annual report for that period, but need not be repeated in the annual report.

Because fund shareholder reports will now contain disclosure with respect to all advisory contracts approved by the board, we are removing the existing requirement for disclosure in the SAI of Forms N-1A, N-2, and N-3 with respect to the board's approval of any existing investment advisory contract. We agree with commenters who argued that requiring discussion of the board's basis for approving an advisory contract in multiple locations is duplicative.

However, we also agree with commenters who argued that it is important for investors to have access to information about advisory contract approvals before investing in a fund. For that reason, we are requiring that a fund prospectus state that a discussion regarding the board of directors' basis for approving any investment advisory contract is available in the fund's annual or semi-annual report to shareholders, as applicable.[27] This disclosure will be required to indicate the dates covered by the relevant shareholder report, so that a shareholder may easily request the appropriate report. The disclosure will be required to appear adjacent to other prospectus disclosure about the fund's investment adviser.[28]

The amendments we are adopting today will therefore result in complementary disclosure requirements in fund shareholder reports, prospectuses, and proxy statements. The disclosure requirement in shareholder reports will provide existing fund shareholders with information about any board approval of an investment advi-

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[27] Item 5(a)(1)(iii) of Form N-1A; Item 9.1.b.(4) of Form N-2; Item 6(b)(iii) of Form N-3.

[28] Item 5(a)(1)(ii) of Form N-1A; Item 9.1.b.(3) of Form N-2; Item 6(b)(ii) of Form N-3.

sory contract during the most recent fiscal half-year. The prospectus disclosure requirement will inform prospective investors that this information is available in shareholder reports. Finally, the existing disclosure requirement in fund proxy statements will continue to apply to any recommendation that shareholders approve an investment advisory contract.

Several commenters recommended that funds be either encouraged or required to disclose information concerning board approval of investment advisory contracts on their Web sites. These commenters argued that Web site disclosure would provide investors with quick and easy access to this information at low cost. We note that we have recently taken steps to encourage Web site disclosure of fund shareholder reports, by proposing amendments that would require that the cover page of a fund prospectus state whether the fund makes available its shareholder reports on or through its Web site.[29]

B. Disclosure Enhancements

We are adopting several enhancements to the existing proxy statement disclosure requirements and are including these same enhancements in the new shareholder reports disclosure requirement. These enhancements clarify and reinforce a fund's obligation under the existing proxy disclosure requirement to discuss the material factors and the conclusions with respect thereto that formed the board's basis for recommending that the shareholders approve an advisory contract. They are intended to address our concerns that some funds do not provide adequate specificity regarding the board's basis for its decision. We are adopting the enhancements substan-

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[29] *See* Investment Company Act Release No. 26383 (Mar. 11, 2004) [69 FR 12752 (Mar. 17, 2004)] (proposed Item 1(b)(1) of Form N-1A, Item 1.1.d of Form N-2, and Item 1(a)(vi) of Form N-3).

tially as proposed, with some modifications to address commenters' concerns.

Selection of Adviser and Approval of Advisory Fee. The amendments clarify that the fund's discussion must include factors relating to both the board's selection of the investment adviser, and its approval of the advisory fee and any other amounts to be paid under the advisory contract.[30] Two commenters objected to the use of the phrase "selection of the investment adviser," arguing that this language suggests that the annual review and approval of the advisory contract is an annual opportunity to replace the investment adviser, and that it is not the role of the directors, except in the most egregious circumstances, to override the investors' choice of an adviser. We note, however, that although we would not expect that fund boards would routinely replace investment advisers, the board does have a duty to monitor the adviser's performance of its duties under the advisory contract, and to consider replacing the adviser if necessary. The directors' decision to renew an investment advisory contract, in effect, constitutes the selection of the investment adviser.

Specific Factors. The amendments will require a fund to include a discussion including, but not limited to, the following: (1) The nature, extent, and quality of the services to be provided by the investment adviser; (2) the investment performance of the fund and the investment adviser; (3) the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the fund; (4) the extent to which economies of scale would be realized as the

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[30] Item 21(d)(6)(i) of Form N-1A; Instruction 6.e.(i) to Item 23 of Form N-2; Instruction 6(v)(A) to Item 27(a) of Form N-3; Item 22(c)(11) (i) of Schedule 14A.

fund grows; and (5) whether fee levels reflect these economies of scale for the benefit of fund investors.[31]

We are adding an instruction to clarify that if any of the enumerated factors is not relevant to the board's evaluation of an investment advisory contract, the discussion must note this and explain the reasons why that factor is not relevant.[32] This instruction is intended to address the concerns of commenters who argued that the proposal should be modified to allow for less or different disclosure with respect to advisory contracts with "non-sponsor advisers" (*i.e.*, investment advisers, including subadvisers, to funds that are sponsored by third parties unaffiliated with the adviser). These commenters claimed that more tailored disclosure would be appropriate for such advisory contracts because the relationship between an unaffiliated subadviser or a non-sponsor adviser and a fund is truly "arm's-length." They also argued that the factors that directors would consider in approving an advisory contract with an unaffiliated subadviser or non-sponsor adviser are different.

The instruction we are adding will permit a fund, including a fund with a non-sponsor adviser, to tailor its disclosure to its particular circumstances. At the same time, it will require each fund to address each of the

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[31] *Id.* Courts have used similar factors in determining whether investment advisers have met their fiduciary obligations under section 36(b) of the Investment Company Act [15 U.S.C. 80a-35(b)]. *See, e.g., Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 929 (2nd Cir. 1982) ("*Gartenberg*") (examining several factors, including "the adviser-manager's cost in providing the service, the nature and quality of the service, the extent to which the adviser-manager realizes economies of scale as the fund grows larger, and the volume of orders which must be processed by the manager").

[32] Instruction 3 to Item 21(d)(6) of Form N-1A; Instruction 6.f. to Item 23 of Form N-2; Instruction 6(vi) to Item 27(a) of Form N-3; Instruction 2 to Item 22(c)(ii) of Schedule 14A.

enumerated factors, either substantively or by explaining why the factor is not relevant. This degree of uniformity in the discussion is designed to facilitate investor understanding of board approvals of investment advisory contracts. We emphasize that it is important that a fund disclose how a board evaluated and approved all investment advisory contracts, including contracts with non-sponsor advisers, such as unaffiliated subadvisers. Under the Investment Company Act, a fund's board plays an important role in the selection and oversight of the fund's adviser and subadvisers, and the fact that these contracts are the result of "arm's length" negotiations does not remove the need for board oversight.[33] Unaffiliated subadvisers may, for example, have other material business arrangements with the fund's adviser or principal underwriter, which the board should consider in the course of evaluating a subadviser's contract.[34]

We note that the amendments are not intended to require disclosure of the amount of the fee paid to an unaffiliated subadviser if that information would not otherwise be required to be disclosed. For example, if a manager of managers fund is not otherwise required to

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[33] *See* Investment Company Act Release No. 26230 (Oct. 23, 2003) [68 FR 61720, 61723 (Oct. 29, 2003)] ("Manager of Managers Proposing Release") (proposing rules that would codify exemptive orders issued for "manager of manager" funds that permit such funds to operate without obtaining shareholder approval when the fund's principal investment adviser hires a new subadviser or replaces an existing subadviser).

[34] *See* Manager of Managers Proposing Release, *supra* note 33, 68 FR at 61723 n.37 (noting that, in carrying out its obligations under section 15(c) of the Investment Company Act, a board should consider any material business arrangements between the adviser or principal underwriter and the subadviser, including the involvement of the subadviser in the distribution of the fund's shares).

disclose separately the fee paid to each subadviser, the amendments would not require this disclosure.[35]

Under the amendments, a fund's discussion is required to state how the board evaluated the costs of the services to be provided and the profits to be realized by the investment adviser and its affiliates from the relationship with the fund. One commenter argued that, to the extent that actual operating cost and profit information is required, such disclosure could have harmful competitive effects on investment advisers, and that in any event disclosure of specific cost and profit figures is not necessary to help investors understand the board's evaluation of this factor. We wish to clarify that disclosure of specific proprietary information about the operating costs and profits of the investment adviser and its affiliates is not necessary to meet this requirement.

Comparison of Fees and Services Provided by Adviser. The fund's discussion will be required to indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory

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[35] Sponsors of manager of managers funds have represented that they are able to negotiate lower fees with subadvisers if they do not have to disclose those fees separately, and in our exemptive orders we have provided them relief from our disclosure requirements. *See, e.g.*, Endeavor Series Trust, Investment Company Act Release Nos. 24054 (Sept. 27, 1999) [64 FR 53428 (Oct. 1, 1999)] (notice) and 24108 (Oct. 22, 1999) [70 SEC Docket 3081 (Nov. 23, 1999)] (order); Frank Russell Investment Company, Investment Company Act Release Nos. 21108 (June 2, 1995) [60 FR 30321 (June 8, 1995)] (notice) and 21169 (June 28, 1995) [59 SEC Docket 2105 (July 25, 1995)] (order). The Commission has proposed form amendments that, if adopted, would permit a manager of managers fund to disclose only the aggregate amount of advisory fees that it pays to subadvisers as a group, rather than the fee paid to each unaffiliated subadviser. Manager of Managers Proposing Release, *supra* note 33, 68 FR at 61722.

contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.*, pension funds and other institutional investors). If the board relied upon such comparisons, the discussion will be required to describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved.[36]

Commenters were divided on the proposed requirement with respect to comparisons of fees and services. Several commenters supported the proposed requirement, arguing that any responsible board would at least seek to compare the terms of the contract under consideration with relevant terms for similar funds, and that by encouraging boards to compare the compensation funds pay to their advisers with the compensation that other institutional investors pay, there may be a downward pressure on fund advisory fees. By contrast, one commenter objected to the requirement insofar as it relates to comparisons with other types of clients, particularly pension funds. This commenter argued that fund boards typically do not use such comparisons as a basis for approving or renewing advisory contracts, but that, to avoid providing negative disclosure that the board did not consider the use of such comparisons, fund boards may feel compelled to consider this factor, notwithstanding its lack of relevance. We are adopting the requirement as proposed because we believe that information concerning whether and, if so, how the board relies on comparisons is important in understanding the board's decision. As adopted, the amendment requires a description of the comparisons upon which the board relied and how they

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[36] Item 21(d)(6)(i) of Form N-1A; Instruction 6.e.(i) to Item 23 of Form N-2; Instruction 6(v)(A) to Item 27(a) of Form N-3; Item 22(c)(11)(i) of Schedule 14A.

assisted the board in concluding that the contract should be approved, and does not require an enumeration of the types of comparisons that the board did not use.

Evaluation of Factors. The existing SAI and proxy statement requirements state that conclusory statements or a list of factors will not be considered sufficient disclosure, and that a fund's discussion must relate the factors to the specific circumstances of the fund and the investment advisory contract.[37] We are clarifying this by requiring that the fund's discussion state how the board evaluated each factor. For example, it will not be sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its determination that the contract should be approved.[38]

Commenters' views on this proposed requirement were divided. On the one hand, some commenters agreed that the requirement that the discussion state how the board evaluated each factor would be useful in ensuring that the discussion has reasonable detail and does not rely on boilerplate disclosure. On the other hand, some commenters argued that detailed information regarding the factors that the board considered and the conclusions it reached is not of interest to most shareholders, and that, as a factual matter, boards typically determine whether to approve an advisory contract based on the totality of the factors considered. We believe that the proposed requirement will elicit more useful information

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[37] *See* Instruction to Item 13(b)(10) of Form N-1A; Instruction to Item 18.13 of Form N-2; Instruction to Item 20(1) of Form N-3; Instruction to Item 22(c)(11) of Schedule 14A.

[38] Instruction 2 to Item 21(d)(6) of Form N-1A; Instruction 6.f. to Item 23 of Form N-2; Instruction 6(vi) to Item 27(a) of Form N-3; Instruction 1 to Item 22(c)(11) of Schedule 14A.

than the existing requirement. It would be difficult for a board to reach a final conclusion as to whether to approve an advisory contract without reaching conclusions as to each material factor that forms the basis for the board's approval. Therefore, a discussion of the board's evaluation of the individual factors is important in order to help investors understand how the board reached its decision on whether to approve such a contract.[39]

C. Compliance Date

The effective date for the amendments to the requirements for fund reports to shareholders and proxy statements is August 5, 2004. All fund reports to shareholders with respect to periods ending on or after March 31, 2005, and all proxy statements filed on or after October 31, 2004, will be required to comply with the amendments. We are selecting the March 31, 2005 compliance date so that a fund will only be required to comply with the new disclosure requirements prospectively, with respect to board approvals occurring on or after October 1, 2004. This will give funds sufficient time to update their recordkeeping procedures in light of the new disclosure requirements, and to determine whether additional procedures for board approval of the disclosure that will be required in shareholder reports

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[39] In determining whether an advisory fee violates section 36(b) of the Investment Company Act, courts have similarly evaluated the evidence with respect to the individual factors enumerated in *Gartenberg* before reaching a conclusion as to the ultimate issue. *See, e.g., Gartenberg, supra* note 31; *Kalish v. Franklin Advisers, Inc.*, 742 F. Supp. 1222, 1228-1250 (S.D.N.Y. 1990), *aff'd*, 928 F.2d 590 (2nd Cir.), *cert. denied*, 502 U.S. 818 (1991); *Krinsk v. Fund Asset Management*, 715 F. Supp. 472, 486-503 (S.D.N.Y. 1988), *aff'd*, 875 F.2d 404 (2nd Cir.), *cert. denied*, 493 U.S. 919 (1989); *Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 663 F. Supp. 962, 973-989 (S.D.N.Y.), *aff'd*, 835 F.2d 45 (2nd Cir. 1987), *cert. denied*, 485 U.S. 1034 (1988).

are needed in order to enable the fund's principal executive and financial officers to certify this disclosure. All initial registration statements on Forms N-1A, N-2, and N-3, and all post-effective amendments that are annual updates to effective registration statements, filed on or after the transmission to shareholders of a report containing the required disclosure must include the prospectus disclosure stating that a discussion regarding the board's basis for approving any investment advisory contract is available in the fund's shareholder reports.

The effective date for the amendments to Item 12 of Form N-1A, Item 18 of Form N-2, and Item 20 of Form N-3 that remove the current SAI disclosure requirement with respect to the board's approval of any existing investment advisory contract is January 31, 2006. By that date, every fund should have begun providing disclosure in its shareholder reports regarding the board's decision to approve the fund's investment advisory contract. Prior to January 31, 2006, a fund may omit disclosure in its SA2 with respect to any board approval of an investment advisory contract if it has previously provided the required disclosure with respect to that board approval in a shareholder report.

III. Paperwork Reduction Act

As explained in the Proposing Release, certain provisions of the amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.[40] The titles for the collections of information are: (1) "Rule 30e-1 under the Investment Company Act of 1940, Reports to Stockholders of Management Companies"; (2) "Form N-1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies"; (3) "Form N-2—Registration

[40] 44 U.S.C. 3501, *et seq.*

Statement of Closed-End Management Investment Companies"; (4) "Form N-3—Registration Statement of Separate Accounts Organized as Management Investment Companies"; and (5) "Rule 20a-1 under the Investment Company Act, Solicitations of Proxies, Consents, and Authorizations." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid 0MB control number.

Rule 30c-1 (OMB Control No. 3235-0025) was adopted under Section 30(e) of the Investment Company Act.[41] Form N-1A (OMB Control No. 3235-0307), Form N-2 (OMB Control No. 3235-0026), and Form N-3 (OMB Control No. 3235-0316) were adopted pursuant to Section 8(a) of the Investment Company Act[42] and Section 5 of the Securities Act.[43] Rule 20a-1 (OMB Control No. 3235-0158) was adopted pursuant to Section 20(a) of the Investment Company Act.[44]

We are adopting amendments to the requirements for fund shareholder reports in Forms N-1A, N-2, and N-3 that will require funds to provide disclosure regarding the material factors that formed the basis for the board of directors' approval of an investment advisory contract during the most recent fiscal half-year. The additional burden hours imposed by these amendments are reflected in the collection of information requirements for shareholder reports required by rule 30e-1 under the Investment Company Act. In addition, we are removing requirements from Forms N-1A, N-2, and N-3 that require funds to provide disclosure in the SAI of these

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[41] 15 U.S.C. 80a-29(e).

[42] 15 U.S.C. 80a-8(a).

[43] 15 U.S.C. 77e.

[44] 15 U.S.C. 80a-20(a).

forms with respect to the basis of the board's approval of any advisory contract, and we are adding a provision requiring funds to provide a reference in the prospectus to the availability of the new disclosure in fund shareholder reports. Finally, we are adopting amendments to Schedule 14A that will clarify and reinforce funds' existing obligation to provide disclosure in proxy statements of the board of directors' basis for a recommendation that shareholders approve an investment advisory contract.

We published notice soliciting comments on the collection of information requirements in the Proposing Release and submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.[45] OMB approved these collection requirements. We received no comments on the collection of information requirements.

Shareholder Reports

Rule 30e-1, which requires funds to include in the shareholder reports the information that is required by the fund's registration statement form, including the amendments, contains collection of information requirements.[46] The respondents to this collection of information requirement are funds registered on Forms N-1A, N-2, and N-3. Compliance with the disclosure requirements of rule 30e-1 is mandatory. Responses to the disclosure requirements will not be kept confidential.

We estimate that there are approximately 3,800 investment companies subject to rule 30e-1. The current approved hour burden for preparing and filing semi-

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[45] *See* Proposing Release, *supra* note 1, 69 FR at 7855-7856.

[46] The amendments are to the shareholder reports requirements in Forms N-1A, N-2, and N-3. Rule 30e-1(a) under the Investment Company Act [17 CFR 270.30e-1(a)] requires funds to include in the shareholder reports the information that is required by the fund's registration statement form.

annual or annual shareholder reports in compliance with rule 30e-1 is 143.3 hours per report per fund, or a total of 1,088,984 annual burden hours (143.3 hours per report x 2 reports x 3,800 funds).

We currently estimate that the 3,800 funds filing annual and semi-annual shareholder reports pursuant to rule 30e-1 include 9,706 portfolios, including 8,938 portfolios of open-end management investment companies ("mutual funds") registered on Form N-1A, 733 closed-end funds registered on Form N-2, and 35 sub-accounts of managed separate accounts registered on Form N-3.[47] We continue to estimate that the proposed amendments will increase the estimated burden hours for complying with rule 30e-1 by 2 hours per portfolio annually. Accordingly, the estimated total annual hour burden for all funds for complying with rule 30e-1 is 1,108,396 hours (1,088,984 hours + (9,706 portfolios x 2 hours)).

Form N-1A

Form N-1A, including the proposed amendments, contains collection of information requirements. The likely respondents to this information collection are open-end funds registering with the Commission. Compliance with the disclosure requirements of Form N-1A is mandatory. Responses to the disclosure requirements are not confidential.

The current estimated total annual hour burden for preparing registration statements on Form N-1A is 1,142,296 hours.[48] In the Proposing Release, we esti-

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[47] The estimates of the number of mutual fund portfolios registered on Form N-1A, the number of closed-end funds registered on Form N-2, and the number of sub- accounts of managed separate accounts registered on Form N-3 are based on the Commission staff's analysis of reports filed on Form N-SAR in 2003.

[48] This number includes additional hour burdens that would be imposed if the Commission adopts its recently proposed rules relating

mated that the proposed amendments would not increase the hour burden for filing registration statements on Form N-1A.

The Commission estimates that, on an annual basis, registrants file initial registration statements on Form N-1A covering 483 portfolios, and file post-effective amendments on Form N-1A covering 8,455 portfolios. We estimate that the amendments we are adopting to Form N-1A that remove the current requirement for a fund to provide disclosure in the SAI concerning the board's basis for approving an existing investment advisory contract will reduce the hour burden per portfolio per filing of an initial registration statement by 2 hours and will reduce the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 2 hours, thereby reducing the total annual hour burden by 17,876 hours.[49] In addition, we estimate that the amendments we are adopting that require a fund to provide a reference in its prospectus to the availability of the required disclosure in fund shareholder reports will have no impact on the hour burden for filing registration statements on Form N-1A. Thus, the estimated total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments to Form N-1A will be 1,124,420 hours (1,142,296 hours – 17,876 hours).

Form N-2

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to portfolio manager disclosure (30,998 additional hours), and disclosure of sales loads and revenue sharing in connection with the proposals for new mutual fund confirmation and point of sale disclosure (1,968 additional hours). Investment Company Act Release No. 26383 (Mar. 11, 2004) [69 FR 12752, 12759 (Mar. 17, 2004)]; Exchange Act Release No. 49148 (Jan. 29, 2004) [69 FR 6438, 6474 (Feb. 10, 2004)].

[49] This estimate is based on the following calculation: (2 hours x 483 portfolios) + (2 hours x 8,455 portfolios) = 17,876 hours.

Form N-2, including the proposed amendments, contains collection of information requirements. The likely respondents to this information collection are closed-end funds registering with the Commission. Compliance with the disclosure requirements of Form N-2 is mandatory. Responses to the disclosure requirements are not confidential.

The current estimated total annual hour burden for preparing an initial registration statement on Form N-2 is 134,844 hours.[50] In the Proposing Release, we estimated that the proposed amendments would not increase the hour burden for filing registration statements on Form N-2.

The Commission estimates that, on an annual basis, 234 closed-end funds file initial registration statements on Form N-2, and 38 closed-end funds file post-effective amendments on Form N-2. We estimate that the amendments we are adopting to Form N-2 that remove the current requirement for a fund to provide disclosure in the SAI concerning the board's basis for approving an existing investment advisory contract will reduce the hour burden per portfolio per filing of an initial registration statement by 2 hours and will reduce the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 2 hours, thereby reducing the total annual hour burden by 544 hours.[51] In addition, we estimate that the amendments we are adopting that require a fund to provide a reference in its prospectus to the availability of the required disclosure in fund share-

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[50] This number includes the additional hour burden that would be imposed if the Commission adopts its recently proposed rules relating to portfolio manager disclosure (2,492 additional hours). *See* Investment Company Act Release No. 26383, *supra* note 48.

[51] This estimate is based on the following calculation: (2 hours x 234 portfolios) + (2 hours x 38 portfolios) = 544 hours.

holder reports will have no impact on the hour burden for filing registration statements on Form N-2. Thus, the estimated total annual hour burden for all closed-end funds for preparation and filing of initial registration statements and post-effective amendments to Form N-2 will be 134,300 hours (134,844 hours - 544 hours).

Form N-3

Form N-3, including the proposed amendments, contains collection of information requirements. The likely respondents to this information collection are separate accounts, organized as management investment companies offering variable annuities, registering with the Commission on Form N-3. Compliance with the disclosure requirements of Form N-3 is mandatory. Responses to the disclosure requirements are not confidential.

The current estimated total annual hour burden for preparing registration statements on Form N-3 is 34,832 hours.[52] In the Proposing Release, we estimated that the proposed amendments would not increase the hour burden for filing registration statements on Form N-3.

The Commission estimates that, on an annual basis, initial registration statements covering 3 portfolios are filed on Form N-3 and post-effective amendments covering 35 portfolios are filed on Form N-3. We estimate that the amendments we are adopting to Form N-3 that remove the current requirement for a fund to provide disclosure in the SAI concerning the board's basis for approving an existing investment advisory contract will reduce the hour burden per portfolio per filing of an initial registration statement by 2 hours and will reduce

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[52] This number includes the additional hour burden that would be imposed if the Commission adopts its recently proposed rules relating to portfolio manager disclosure (170 additional hours). *See* Investment Company Act Release No. 26383, *supra* note 48.

the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 2 hours, thereby reducing the total annual hour burden by 76 hours.[53] In addition, we estimate that the amendments we are adopting that require a fund to provide a reference in its prospectus to the availability of the required disclosure in fund shareholder reports will have no impact on the hour burden for filing registration statements on Form N-3. Thus, the estimated total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments to Form N-3 will be 34,756 hours (34,832 hours – 76 hours).

Proxy Statements

Rule 20a-1, including the proposed amendments to Schedule 14A, contains collection of information requirements.[54] The respondents to this collection of information requirement include funds registered on Forms N-1A, N-2, and N-3. Compliance with the disclosure requirements of rule 20a-1 is mandatory. Responses to the disclosure requirements are not confidential.

The amendments to Schedule 14A will clarify and reinforce funds' existing obligation to provide disclosure in proxy statements regarding the board's basis for recommending that shareholders approve an investment advisory contract. Because funds are already required to provide disclosure in appropriate detail regarding the

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[53] This estimate is based on the following calculation: (2 hours x 3 portfolios) + (2 hours x 35 portfolios) = 76 hours.

[54] The amendments are to Item 22 of Schedule 14A. Rule 20a-1 requires funds to comply with Regulation 14A, Schedule 14A, and all other rules and regulations adopted pursuant to section 14(a) of the Exchange Act that would be applicable to a proxy solicitation if it were made in respect of a security registered pursuant to section 12 of the Exchange Act. The annual responses to rule 20a-1 reflect the number of proxy and information statements that are filed by funds.

material factors and the conclusions with respect thereto that formed the board's basis for recommending shareholder approval of an investment advisory contract, we continue to estimate that the amendments will not increase the hour burden for complying with the requirements of rule 20a-1.

IV. Cost/Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. The amendments that the Commission is adopting will require funds to improve the disclosure that they provide regarding the fund board's basis for approving, or recommending that shareholders approve, an investment advisory contract. Specifically, the amendments will:

- Require fund shareholder reports to discuss, in reasonable detail, the material factors and the conclusions with respect to those factors that formed the basis for the board's approval of an advisory contract during the most recent fiscal half-year;
- Require a fund to provide a statement in its prospectus about the availability of the required disclosure in fund shareholder reports; and
- Enhance the existing requirement for a fund to provide disclosure in a proxy statement seeking approval of an investment advisory contract about the board's basis for its recommendation that shareholders approve the contract.

A. Benefits

The amendments we are adopting will improve the disclosure provided by funds about how their boards of directors evaluate and approve, and recommend shareholder approval of, investment advisory contracts. First, the amendments will provide existing fund shareholders with more timely information about the basis for the board's approval of investment advisory contracts. The

increased visibility of this disclosure resulting from its inclusion in shareholder reports may encourage funds to provide a meaningful explanation of the board's basis for approving an investment advisory contract. This, in turn, may benefit investors by encouraging them to consider more carefully the costs and value of the services rendered by the fund's investment adviser, and by enabling them to make more informed choices among funds.

In addition, the increased visibility of this disclosure in shareholder reports may encourage fund boards to engage in more vigorous and independent oversight of investment advisory contracts. This increased oversight by fund boards will also benefit investors. The requirement that funds provide a statement in the prospectus about the availability of the new disclosure in shareholder reports will further this goal by assisting investors in finding the new disclosure.

We also are removing current requirements from Forms N-1A, N-2, and N-3 that require funds to provide disclosure in the SAI with respect to the basis of the board's approval of any advisory contract, since this disclosure will now be available in shareholder reports. For purposes of the Paperwork Reduction Act, we have estimated that the amendments to Forms N-1A, N-2, and N-3 will reduce the annual hour burden for filing each form by 17,876 hours, 544 hours, and 76 hours, respectively, for a total reduction in annual burden of 18,496 hours. We estimate that this reduction in the annual hour burden will equal total internal cost savings of $1,549,410 annually, or approximately $408 per investment company.[55] The removal of these disclosure re-

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[55] These figures are based on a Commission estimate that approximately 3,800 investment companies would be subject to the amendments and an estimated hourly wage rate of $83.77. The estimate of the number of investment companies is based on data derived from

quirements also will result in some external cost savings, but because this disclosure was included in a fund's SAI, which is typically not typeset, and is only required to be provided to shareholders upon request, we estimate that these savings will be minimal.

The amendments will also clarify and reinforce funds' obligation under the existing disclosure requirements in proxy statements to discuss the material factors and the conclusions with respect thereto that formed the basis for the board's approval of the fund's existing advisory contract, or its recommendation that shareholders approve an investment advisory contract. This improved disclosure in proxy statements will also benefit investors.

B. Costs

The amendments will impose new requirements on funds to provide disclosure in their shareholder reports regarding the fund board's basis for approving an investment advisory contract. We estimate that complying with the new disclosure requirements will entail a relatively small financial burden. Funds currently are re-

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the Commission's EDGAR filing system. The estimated wage rate is a blended rate, based on published hourly wage rates for assistant/associate general counsels ($82.05) and programmers ($42.05) in New York City, and the estimate that staff in these categories will divide time equally on compliance with the disclosure requirements, yielding a weighted wage rate of $62.05 (($82.05 x .50) + (42.05 x .50))= $62.05). *See* Securities Industry Association, *Report on Management & Professional Earnings in the Securities Industry 2003* (Sept. 2003). This weighted wage rate was then adjusted upward by 35% for overhead, reflecting the costs of supervision, space, and administrative support, to obtain the total per hour internal cost of $83.77 ($62.05 x 1.35) = $83.77). This estimated wage rate for compliance attorneys differs from the estimate in the Proposing Release, which was based on published compensation for compliance attorneys in New York City ($74.22) contained in the Securities Industry Association's *Report on Management & Professional Earnings in the Securities Industry 2001* (Oct. 2001).

quired to provide similar disclosure in their SAIs and in relevant proxy statements, and the required information regarding a fund board's evaluation of each advisory contract should be readily available to management and to the fund board. Therefore, we expect that the cost of compiling this information should be minimal, and the primary costs attributable to the amendments will be those of reporting this information. These costs may include both internal costs (for attorneys and non-legal staff to prepare and review the required disclosure) and external costs (for printing, and typesetting, and mailing of the disclosure).

For purposes of the Paperwork Reduction Act, we have estimated that the new disclosure requirements will increase the annual hour burden for completing a shareholder report in compliance with rule 30e-1 under the Investment Company Act by 19,412 hours. We estimate that this additional burden will equal total internal costs of $1,626,143 annually, or approximately $428 per investment company.[56] In addition, we have estimated that the amendments to Schedule 14A will have no impact on the hour burden for complying with rule 20a-1 under the Investment Company Act.

The external costs of providing the enhanced disclosure in fund shareholder reports regarding the process by which a fund board reviews and approves an investment advisory contract are expected to be limited, but will depend on the individual circumstances of each fund and its contractual relationships with its advisers and sub-advisers, and the nature of the process by which the board determines whether to approve the fund's advisory contract. We estimate that the additional disclosure that will be required in shareholder reports may add one additional page to a fund's annual or semi-annual report, at a

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[56] *See supra* note 55.

cost of $0.02 per page.[57] We estimate that there are approximately 257 million fund shareholder accounts which would send out 231 million reports to shareholders annually that will include the required disclosure.[58] Therefore, we estimate that the additional disclosure in shareholder reports will cost approximately $4,620,000 (231 million shareholder reports x $0.02 per page) in external costs for funds annually.

For purposes of the Paperwork Reduction Act, we have estimated that the amendments that we are adopting that require a fund to provide a reference in its prospectus to the availability of the required disclosure in fund shareholder reports will not result in an increase in internal costs. Similarly, we expect that the external costs of providing the new prospectus disclosure will be minimal, because this disclosure will not add significant length to the prospectus.

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[57] This cost per page is based on an estimate that the typical shareholder report is approximately 25 pages long and costs $.52 to print and deliver. *See* Securities Act Release No. 33-7766 (Nov. 4, 1999) [64 FR 62540, 62543 (Nov. 16, 1999)].

[58] Investment Company Institute, Mutual Fund Fact Book 65 (43rd ed. 2003), at 63 (estimating approximately 251 million shareholder accounts associated with mutual funds). In addition, we estimate that there are approximately 2 million shareholder accounts associated with closed-end funds registered on Form N-2 and approximately 4 million shareholder accounts associated with managed separate accounts registered on Form N-3. These figures are based on the Commission staff's analysis of reports filed on Form N-SAR in 2003. We estimated the number of shareholder reports by reducing the number of accounts by 10% to reflect an estimated 10% savings in the number of reports that must be delivered to shareholders due to householding rules.

V. Consideration of Burden on Competition; Promotion of Efficiency, Competition, and Capital Formation

Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) also prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[59] In addition, section 2(c) of the Investment Company Act,[60] section 2(b) of the Securities Act,[61] and section 3(f) of the Exchange Act[62] require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. In the Proposing Release, we requested comment on whether the proposed amendments would promote efficiency, competition, and capital formation. We received no comments on this issue.

The amendments are designed to encourage better, more visible, and more timely disclosure to fund shareholders about the material factors, and the conclusions with respect to those factors, that formed the basis for the decision of a fund's board of directors to approve or renew an investment advisory contract, or to recommend approval of an investment advisory contract. These amendments may thereby improve efficiency. By increasing transparency with respect to advisory fees, the amendments may assist investors in making informed

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[59] 15 U.S.C. 78w(a)(2).

[60] 15 U.S.C. 80a-2(c).

[61] 15 U.S.C. 77(b).

[62] 15 U.S.C. 78c(f).

choices among funds and encourage fund boards to engage in vigorous and independent oversight of advisory contracts, which may promote more efficient allocation of investments by investors and more efficient allocation of assets among competing funds. These amendments may also improve competition, as enhanced transparency regarding the board's basis for approving an investment advisory contract may encourage investors to consider more carefully the costs and value of the services rendered by the fund's investment adviser. Finally, the amendments have no effect on capital formation.

As noted above, we believe that the amendments will benefit investors. We note that funds currently are required to provide similar disclosure in their SAIs and in relevant proxy statements.

VI. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis ("Analysis") has been prepared in accordance with 5 U.S.C. 604, and relates to the Commission's rule and form amendments under the Securities Act, the Exchange Act, and the Investment Company Act to encourage better, more prominent, and more timely disclosure to shareholders about the basis on which the board of directors of a fund approves, and recommends shareholder approval of, investment advisory contracts. An Initial Regulatory Flexibility Analysis ("IRFA"), which was prepared in accordance with 5 U.S.C. 603, was published in the release proposing these amendments.

A. Reasons for, and Objectives of, Amendments

Sections I and II of this Release describe the reasons for and objectives of the amendments. As discussed in detail above, the amendments adopted by the Commission are designed to increase the transparency of the information that a fund provides regarding the board's basis for approving an investment advisory contract, or

recommending that shareholders approve an investment advisory contract.

B. Significant Issues Raised by Public Comment

In the IRFA for the proposed amendments, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed amendments, the likely impact of the proposal on small entities, the nature of any impact, and we asked commenters to provide any empirical data supporting the extent of the impact. We received no comment letters on the IRFA.

C. Small Entities Subject to the Rule

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[63] Approximately 145 investment companies registered on Form N-1A meet this definition, and approximately 70 investment companies registered on Form N-2 meet this definition.[64] We estimate that few, if any, registered separate accounts registered on Form N-3 are small entities.[65]

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[63] 17 CFR 270.0-10.

[64] This estimate is based on an analysis by the Division of Investment Management staff of information from databases compiled by third-party information providers, including Morningstar, Inc. and Lipper.

[65] This estimate is based on figures compiled by Division of Investment Management staff regarding separate accounts registered on Form N-3. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are aggregated with the assets of their sponsoring insurance companies. Rule 0-10(b) under the Investment Company Act [17 CFR 270.0-10(b)].

D. Reporting, Recordkeeping, and Other Compliance Requirements.

These amendments will:

- Require fund shareholder reports to discuss, in reasonable detail, the material factors and the conclusions with respect to these factors that formed the basis for the board's approval of an advisory contract during the most recent fiscal half-year;
- Require a fund to provide a statement in its prospectus about the availability of the required disclosure in fund shareholder reports; and
- Enhance the existing requirements for a fund to provide disclosure in a proxy statement seeking approval of an investment advisory contract about the board's basis for its recommendation that shareholders approve the contract.

The Commission estimates some one-time formatting and ongoing costs and burdens that would be imposed on all funds, including funds that are small entities. These include the costs related to providing this disclosure in shareholder reports. These costs also could include expenses for legal fees. These amendments also require that funds provide a statement in the prospectus about the availability of this disclosure in shareholder reports. We note, with respect to the amendments to the disclosure requirements in fund proxy statements, that these amendments would clarify and reinforce funds' obligation under the existing disclosure requirements to discuss the board's basis for approving, or recommending shareholder approval of, any existing investment advisory contract. Finally, these amendments remove existing requirements that funds provide similar disclosure in the SAI. We expect that the cost of compliance with the amendments to the existing disclosure requirements in proxy statements, and the amendments requiring a ref-

erence in the fund prospectus to the new disclosure in shareholder reports, will be minimal. We believe the benefits that will result to shareholders through better information with respect to their fund board's evaluation of such advisory contracts justify these potential costs.

E. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small registrants. In connection with the amendments, the Commission considered the following alternatives: (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed amendments for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The Commission believes at the present time that special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, would not be appropriate or consistent with investor protection. The disclosure amendments will provide shareholders with greater transparency regarding the fund board's basis for approving an investment advisory contract, or recommending that shareholders approve an investment advisory contract. Different disclosure requirements for funds that are small entities may create the risk that the shareholders in these funds would be less able to consider the costs and value of the services rendered by the fund's investment adviser, and less able to make informed choices among funds. We believe it is important for the disclosure that is required by the

amendments to be provided to shareholders by all funds, not just funds that are not considered small entities.

We have endeavored through the amendments to minimize the regulatory burden on all funds, including small entities, while meeting our regulatory objectives. Small entities should benefit from the Commission's reasoned approach to the amendments to the same degree as other investment companies. Further consolidation or simplification of the proposals for funds that are small entities would be inconsistent with the Commission's concern for investor protection. Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context. Based on our past experience, we believe the disclosure will be more useful to investors if there are enumerated informational requirements.

VII. Statutory Authority

The Commission is adopting amendments to Schedule 14A pursuant to authority set forth in sections 14 and 23(a)(1) of the Exchange Act[66] and sections 20(a) and 38 of the Investment Company Act.[67] The Commission is adopting amendments to Forms N-1A, N-2, and N-3 pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act[68] and sections 8, 15, 24(a), 30, and 38 of the Investment Company Act.[69]

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[66] 15 U.S.C. 78n and 78w(a)(1).

[67] 15 U.S.C. 80a-20, 80a-37.

[68] 15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a).

[69] 15 U.S.C. 80a-8, 80a-15, 80a-24(a), 80a-29, and 80a-37.

List of Subjects

17 CFR Parts 239 and 240

Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rule and Form Amendments

▪ For the reasons set out in the preamble, the Commission amends Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

▪ 1. The general authority citation for Part 239 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a-8, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

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PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

▪ 2. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

▪ 3. Section 240.14a-101 is amended by revising paragraph (c)(11) of Item 22 to read as follows:

§240.14a-101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 22. Information required in investment company proxy statement.

* * * * *

(c) * * *

(11) Discuss in reasonable detail the material factors and the conclusions with respect thereto that form the basis for the recommendation of the board of directors that the shareholders approve an investment advisory contract. Include the following in the discussion:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. Also indicate in the discussion whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.*, pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were

relied on and how they assisted the board in determining to recommend that the shareholders approve the advisory contract; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

Instructions. 1. Conclusory statements or a list of factors will not be considered sufficient disclosure. Relate the factors to the specific circumstances of the Fund and the investment advisory contract for which approval is sought and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its determination to recommend approval of the contract.

2. If any factor enumerated in paragraph (c)(11)(i) of this Item 22 is not relevant to the board's evaluation of the investment advisory contract for which approval is sought, note this and explain the reasons why that factor is not relevant.

* * * * *

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

▪ 4. The authority citation for Part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

▪ 5. Form N-1A (referenced in §§ 239.15A and 274.11A) is amended by:

▪ a. Adding Item 5(a)(1)(iii);

- b. Removing Item 12(b)(10), including the Instruction; and
- c. Adding Item 21(d)(6).

The additions read as follows:

Note: The text of Form N-1A does not and this amendment will not appear in the *Code of Federal Regulations.*

FORM N-1A

* * * * *

PART A: INFORMATION REQUIRED IN A PROSPECTUS

* * * * *

Item 5. Management, Organization, and Capital Structure

(a) * * *

(1) * * *

(iii) Include a statement, adjacent to the disclosure required by paragraph (a)(1)(ii) of this Item, that a discussion regarding the basis for the board of directors approving any investment advisory contract of the Fund is available in the Fund's annual or semi-annual report to shareholders, as applicable, and providing the period covered by the relevant annual or semi-annual report.

* * * * *

PART B: INFORMATION REQUIRED IN A STATEMENT OF ADDITIONAL INFORMATION

Item 21. Financial Statements

* * * * *

(d) * * *

(6) *Statement Regarding Basis for Approval of Investment Advisory Contract.* If the board of directors approved any investment advisory contract during the Fund's most recent fiscal half-year, discuss in reasonable detail the material factors and the conclusions with

respect thereto that formed the basis for the board's approval. Include the following in the discussion:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. Also indicate in the discussion whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.*, pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

Instructions.

1. Board approvals covered by this Item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory con-

tracts covered by this Item include subadvisory contracts.

2. Conclusory statements or a list of factors will not be considered sufficient disclosure. Relate the factors to the specific circumstances of the Fund and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

3. If any factor enumerated in paragraph (d)(6)(i) of this Item is not relevant to the board's evaluation of an investment advisory contract, note this and explain the reasons why that factor is not relevant.

* * * * *

▪ 6. Form N-2 (referenced in §§ 239.14 and 274.11a-l) is amended by:

▪ a. Removing "and" from the end of Item 9.1.b(2);

▪ b. Removing the period from the end of Item 9.1.b(3) and in its place adding "; and";

▪ c. Adding Item 9.1.b(4);

▪ d. Removing Item 18.13;

▪ e. Redesignating Items 18.14 through 18.16 as Items 18.13 through 18.15;

▪ f. Adding Instructions 6.e and 6.f to Item 23; and

▪ g. In Instruction 8.a to Item 23, revising the reference "Item 18.16" to read "Item 18.15".

The additions read as follows:

Note: The text of Form N-2 does not and this amendment will not appear in the **Code of Federal Regulations**.

FORM N-2

* * * * *

PART A: INFORMATION REQUIRED IN A PROSPECTUS

* * * * *

Item 9. Management

1. * * *

b. * * *

(4) a statement, adjacent to the disclosure required by paragraph 1.b.(3) of this Item, that a discussion regarding the basis for the board of directors approving any investment advisory contract of the Registrant is available in the Registrant's annual or semi-annual report to shareholders, as applicable, and providing the period covered by the relevant annual or semi-annual report.

* * * * *

PART B: INFORMATION REQUIRED IN A STATEMENT OF ADDITIONAL INFORMATION

* * * * *

Item 23. Financial Statements

* * * * *

Instructions.

* * * * *

6. * * *

e. If the Registrant's board of directors approved any investment advisory contract during the Registrant's most recent fiscal half-year, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board's approval. Include the following in the discussion:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Registrant under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the in-

vestment performance of the Registrant and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Registrant; the extent to which economies of scale would be realized as the Registrant grows; and whether fee levels reflect these economies of scale for the benefit of the Registrant's investors. Also indicate in the discussion whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.*, pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide research to the Registrant or its investment adviser in return for allocating the Registrant's brokerage.

f. Board approvals covered by Instruction 6.e. to this Item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by Instruction 6.e. include subadvisory contracts. Conclusory statements or a list of factors will not be considered sufficient disclosure under Instruction 6.e. Relate the factors to the specific circumstances of the Registrant and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the

amount of the fee and how that affected its decision to approve the contract. If any factor enumerated in Instruction 6.e.(i) to this Item is not relevant to the board's evaluation of an investment advisory contract, note this and explain the reasons why that factor is not relevant.

* * * * *

▪ 7. Form N-3 (referenced in §§ 239.17a and 274.11b) is amended by:

▪ a. Removing "and" from the end of Item 6(b)(i);

▪ b. At the end of Item 6(b)(ii), adding "and";

▪ c. Adding Item 6(b)(iii);

▪ d. Removing Item 20(l);

▪ e. Redesignating Items 20(m) through 20(o) as Items 20(l) through 20(n);

▪ f. Removing "and" from the end of Instruction 6(iii) to Item 27(a);

▪ g. Removing the period from the end of Instruction 6(iv) to Item 27(a) and in its place adding a semi-colon;

▪ h. Adding Instructions 6(v) and 6(vi) to Item 27(a); and

▪ i. In Instruction 8(i) to Item 27(a), revising the reference "Item 20(o)" to read "Item 20(n)".

The additions read as follows:

Note: The text of Form N-3 does not and this amendment will not appear in the *Code of Federal Regulations*.

FORM N-3

* * * * *

PART A: INFORMATION REQUIRED IN A PROSPECTUS

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Item 6. Management

* * * * *

(b) * * *

(iii) a statement, adjacent to the disclosure required by paragraph (b)(ii) of this Item, that a discussion regarding the basis for the board of directors approving any investment advisory contract of the Registrant is available in the Registrant's annual or semi-annual report to shareholders, as applicable, and providing the period covered by the relevant annual or semi-annual report;

* * * * *

PART B: INFORMATION REQUIRED IN A STATEMENT OF ADDITIONAL INFORMATION

* * * * *

Item 27. Financial Statements

(a) * * *

Instructions:

* * * * *

6. * * *

(v) If the Registrant's board of managers approved any investment advisory contract during the Registrant's most recent fiscal half-year, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board's approval. Include the following in the discussion:

(A) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Registrant under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Registrant and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its

affiliates from the relationship with the Registrant; the extent to which economies of scale would be realized as the Registrant grows; and whether fee levels reflect these economies of scale for the benefit of the Registrant's investors. Also indicate in the discussion whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.*, pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(B) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide research to the Registrant or its investment adviser in return for allocating the Registrant's brokerage; and

(vi) Board approvals covered by Instruction 6(v) to this Item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by Instruction 6(v) include subadvisory contracts. Conclusory statements or a list of factors will not be considered sufficient disclosure under Instruction 6(v). Relate the factors to the specific circumstances of the Registrant and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract. If any factor enumerated in Instruction 6(v)(A) to this Item is not relevant to the

board's evaluation of an investment advisory contract, note this and explain the reasons why that factor is not relevant.

* * * * *

By the Commission.

Dated: June 23, 2004.

Margaret K. McFarland,

Deputy Secretary.

[FR Doc. 04-14755 Filed 6-29-04; 8:45 am]

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OPPOSITION BRIEF

Supreme Court, U.S.
FILED
NOV 9 - 2009
OFFICE OF THE CLERK

No. 09-163

IN THE

Supreme Court of the United States

AMERIPRISE FINANCIAL, INC., ET AL.,
Petitioners,

v.

JOHN E. GALLUS, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF FOR THE RESPONDENTS

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November 9, 2009

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QUESTIONS PRESENTED

1. Whether the court of appeals correctly interpreted § 36(b) of the Investment Company Act of 1940 ("ICA"), which provides that investment advisers to mutual funds have "a fiduciary duty with respect to the receipt of compensation" from those funds, 15 U.S.C. § 80a-35(b), to incorporate common-law principles the term "fiduciary duty" embodies.

2. Whether § 36(b)(3) of the ICA, which bars the recovery of damages "for any period *prior to* one year before the action was instituted," 15 U.S.C. § 80a-35(b)(3) (emphasis added), also limits recovery of continuing excessive investment-adviser fees charged *after* the action was instituted.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iv

INTRODUCTION 1

STATEMENT OF THE CASE 2

DISCUSSION 10

I. IF THE COURT REVERSES OR VACATES IN *JONES v. HARRIS ASSOCIATES L.P.*, No. 08-586, THEN IT SHOULD DENY THE PETITION 11

A. The Lower Courts Can Implement This Court's Decision In *Jones* Without Further Action By This Court 11

B. The Court Of Appeals' Decision Is Correct 12

1. Section 36(b)'s fiduciary duty requires full disclosure and fairness 12

2. Petitioners' criticisms of the decision below lack merit 15

II. REVIEW OF THE EIGHTH CIRCUIT'S CORRECT INTERPRETATION OF § 36(b)'S DAMAGES PERIOD IS UNWARRANTED IN ANY EVENT 19

A. The Eighth Circuit's Decision Conflicts With No Decision Of This Court Or Any Other Court Of Appeals 19

B. The Eighth Circuit's Interpretation Of § 36(b)(3) Is Correct 20

C. The Eighth Circuit's Decision Is Interlocutory 22

CONCLUSION 23

TABLE OF AUTHORITIES

Page

CASES

Brotherhood of Locomotive Firemen v. Bangor & Aroostook R.R., 389 U.S. 327 (1967) 22-23

Burks v. Lasker, 441 U.S. 471 (1979) 2, 18

Central Virginia Community College v. Katz, 546 U.S. 356 (2006) 19

Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984) 2, 3, 4, 18, 19

Dumond v. Massachusetts Fin. Servs. Co., No. 04-11458-GAO, 2007 WL 602589 (D. Mass. Feb. 22, 2007) 21

Franklin Mut. Funds Fee Litig., In re, 478 F. Supp. 2d 677 (D.N.J. 2007) 20

Gallus v. American Express Fin. Corp., 370 F. Supp. 2d 862 (D. Minn. 2005) 5

Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982) 6, 7, 8

Green v. Nuveen Advisory Corp., 295 F.3d 738 (7th Cir. 2002) 19

Hamilton-Brown Shoe Co. v. Wolf Bros. & Co., 240 U.S. 251 (1916) 23

Independent Fed'n of Flight Attendants v. Zipes, 491 U.S. 754 (1989) 22

Jama v. Immigration & Customs Enforcement, 543 U.S. 335 (2005) 20

Jones v. Harris Assocs. L.P.:

No. 04-C-8305, 2007 WL 627640 (N.D. Ill. Feb. 27, 2007), *aff'd*, 527 F.3d 627 (7th Cir. 2008), *cert. granted*, No. 08-586 (Mar. 9, 2009) 7

527 F.3d 627 (7th Cir. 2008), *cert. granted*, No. 08-586 (Mar. 9, 2009) 9

537 F.3d 728 (7th Cir. 2008) 5

Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928) 12

Morris v. American Nat'l Can Corp., 988 F.2d 50 (8th Cir. 1993) 11

Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992) 13

Neder v. United States, 527 U.S. 1 (1999) 13

Pepper v. Litton, 308 U.S. 295 (1939) 12, 13

Riegel v. Medtronic, Inc., 128 S. Ct. 999 (2008) .. 15-16

United States v. Behler, 100 F.3d 632 (8th Cir. 1996) 11

United States v. Elliott, 467 F.3d 688 (7th Cir. 2006) 20

STATUTES AND RULES

Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.* 3, 4, 16, 18, 21

§ 2(a)(19)(B)(iii), 15 U.S.C. § 80a-2(a)(19)(B)(iii) 3

§ 10(a), 15 U.S.C. § 80a-10(a) 3

§ 15(c), 15 U.S.C. § 80a-15(c) 4

§ 36(a), 15 U.S.C. § 80a-35(a) 16

§ 36(b), 15 U.S.C. § 80a-35(b) 1, 4, 5, 7, 10, 12, 13, 14, 15, 16, 17, 18, 19, 21, 22

§ 36(b)(1), 15 U.S.C. § 80a-35(b)(1) 16

§ 36(b)(2), 15 U.S.C. § 80a-35(b)(2) 4

§ 36(b)(3), 15 U.S.C. § 80a-35(b)(3) 1, 4, 6, 9, 10, 11, 16, 17, 20, 21, 22

§ 47(b), 15 U.S.C. § 80a-46(b) 17

Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 ..... 3, 4, 13, 17

Fed. R. Civ. P. 16 22

LEGISLATIVE MATERIALS

Mutual Fund Amendments (Part 1): Hearings Before the Subcomm. on Commerce and Finance of the H. Comm. on Interstate and Foreign Commerce, 91st Cong. (1969) 13, 14, 17, 18

S. Rep. No. 91-184 (1969) 2, 4, 17

OTHER MATERIALS

22 Am. Jur. 2d *Damages* (2003) 21

Restatement (Second) of Trusts (1959) 12

18B Charles Alan Wright et al., *Federal Practice and Procedure* (2d ed. 2002) 12

INTRODUCTION

This case concerns the "fiduciary duty" that investment advisers owe under § 36(b) of the Investment Company Act when seeking compensation from mutual funds that they create and manage. 15 U.S.C. § 80a-35(b). This Court recently heard oral argument in a case involving the proper interpretation of § 36(b), *Jones v. Harris Associates L.P.*, No. 08-586 (argued Nov. 2, 2009). Here, the court of appeals interpreted the statutory term "fiduciary duty" in accordance with its common-law roots to prohibit "[u]nscrupulous behavior" by investment advisers. Pet. App. 13a. The Eighth Circuit reversed the district court's grant of summary judgment for the adviser and remanded for further proceedings because the lower court erroneously ignored "disputed issues of material fact." *Id.* at 14a-15a. The court of appeals also held that the statutory prohibition on damages "for any period *prior to* one year before the action was instituted," 15 U.S.C. § 80a-35(b)(3) (emphasis added), does not bar recovery of damages for periods *after* the action was instituted. *See* Pet. App. 16a-17a.

Petitioners present two questions for this Court's review – one involving the meaning of § 36(b)'s "fiduciary duty" and a second concerning the proper interpretation of the damages period in § 36(b)(3). Pet. i. They assert that this Court should hold the petition and dispose of it in light of *Jones* or, alternatively, grant the petition limited to the second question presented. Pet. 25.

With respect to the first question presented, respondents agree that the petition should be held pending this Court's decision in *Jones*. If this Court reverses or vacates the judgment in *Jones*, it should

deny certiorari in this case, because the Eighth Circuit remanded for further proceedings and the district court can apply this Court's guidance in *Jones* in conducting those proceedings.

Regardless of the outcome in *Jones*, the Court should deny certiorari on the second question. The second question is not before this Court in *Jones*, and petitioners do not claim that the Eighth Circuit's resolution of that issue could be affected by the decision in *Jones*. In addition, petitioners present no conflict in the circuits and no compelling reason for this Court to grant review of the second question. Accordingly, there is no reason to grant the petition with respect to the second question presented regardless of the disposition of the first issue.

STATEMENT OF THE CASE

1. Mutual funds are "typically created and managed by a pre-existing external organization known as an investment adviser." *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 536 (1984) (citing *Burks v. Lasker*, 441 U.S. 471, 481 (1979)). The investment adviser "generally supervises the daily operation of the fund and often selects affiliated persons to serve on the [fund]'s board of directors." *Id.* The relationship between a mutual fund and its investment adviser is thus "fraught with potential conflicts of interest." *Id.* (internal quotation marks omitted). Because of the symbiotic relationship between advisers and their funds, "the forces of arm's-length bargaining" over compensation "do not work in the mutual fund industry in the same manner as they do in other sectors of the American economy." S. Rep. No. 91-184, at 5 (1969); *see* Pet. 5 ("Funds typically do not switch advisers. Advisers thus rarely compete for the business of funds formed by competitor

'families.'"). In response to "the potential for abuse inherent in [that] structure," Congress enacted the Investment Company Act ("ICA") in 1940 and imposed several regulatory safeguards on the mutual-fund industry. *Daily Income Fund*, 464 U.S. at 536 (internal quotation marks omitted); *see id.* at 536-37.

Following the ICA's passage, investment advisers continued to exploit their control over mutual funds to charge excessive fees. Investigations conducted by scholars and the Securities and Exchange Commission ("SEC") found that "investment advisers often charged mutual funds higher fees than those charged the advisers' other clients and further determined that the structure of the industry, even as regulated by the Act, had proven resistant to efforts to moderate adviser compensation." *Id.* at 537. The SEC also concluded that "lawsuits by security holders challenging the reasonableness of adviser fees had been largely ineffective due to the standards employed by courts to judge the fees." *Id.* Relying on approval of adviser compensation by fund boards or shareholders, courts applied state common-law standards of corporate waste, under which fees could be challenged only if they were "unconscionable" or "shocking." *Id.* at 540 & n.12.

To combat the continuing problem of excessive investment-adviser fees, Congress enacted the Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 ("1970 Amendments"). *See Daily Income Fund*, 464 U.S. at 537-39. The 1970 Amendments strengthened the ICA's structural protections by requiring that at least 40 percent of a fund's directors be persons who are not "interested" in the adviser. 15 U.S.C. § 80a-10(a); *id.* § 80a-2(a)(19)(B)(iii). The Act as amended also requires

that a majority of the "noninterested" (commonly referred to as "disinterested") fund directors annually approve the adviser's compensation agreement. *Id.* § 80a-15(c).

Recognizing that even those additional structural safeguards and existing legal standards were insufficient to protect investors, Congress added § 36(b) to the ICA as an "independent check[] on excessive [adviser] fees." *Daily Income Fund*, 464 U.S. at 541. Section 36(b) imposes on investment advisers "a fiduciary duty with respect to the receipt of compensation for services." 15 U.S.C. § 80a-35(b). It also grants shareholders a private right of action. *Id.* Congress provided that courts adjudicating § 36(b) claims would not defer to the fund board's approval of the adviser's compensation, as was common under the "corporate waste" standard. Instead, courts "shall . . . give[]" board approval "such consideration . . . as is deemed appropriate under all the circumstances." *Id.* § 80a-35(b)(2); *see Daily Income Fund*, 464 U.S. at 534 n.10, 540 & n.12. In addition, § 36(b)(3) bars recovery of damages incurred more than one year before the filing of the suit: "No award of damages shall be recoverable for any period prior to one year before the action was instituted." 15 U.S.C. § 80a-35(b)(3).

2. Respondents own shares in mutual funds (the "Funds") for which petitioners serve as the investment adviser. *See* Pet. App. 2a. Petitioners created the Funds, and they manage the Funds' daily operations and distribute the Funds' shares. *See id.* The Funds are thus typical "captive" mutual funds – exactly the type of fund that Congress had in mind when it enacted the ICA and the 1970 Amendments. *See* S. Rep. No. 91-184, at 5 (describing funds that

"are formed, sold, and managed by [investment advisers] that are separately owned and operated"); Pet. App. 6a-7a (typical arrangement "gives the adviser a significant amount of control over the fund"); *Jones v. Harris Assocs. L.P.*, 537 F.3d 728, 731 (7th Cir. 2008) (Posner, J., dissenting from the denial of rehearing en banc) ("there is no doubt" that funds like those at issue here "are indeed captive").

In addition to advising the Funds, petitioners also provide investment advice to a number of independent institutional clients, such as pension funds. Respondents assert that petitioners charge those independent clients fees for advisory services that are materially lower than the fees petitioners charge the Funds for comparable advisory services. *See* Pet. App. 3a. Indeed, the fees the Funds pay are "perhaps up to twice as much" in percentage terms as (or roughly $50 million more in dollar terms than) the fees the independent clients pay for "investment advice" that "may [be] essentially the same." *Id.* at 4a, 14a. Respondents also contend that petitioners misled the Funds' board in negotiating their fees by intentionally obfuscating and distorting information to make it appear as if this fee discrepancy was many times smaller than it actually was. *See id.* at 6a.

3.a. On June 9, 2004, respondents sued petitioners in federal district court, alleging that petitioners breached their fiduciary duty to the Funds, in violation of § 36(b). *See* Pet. App. 2a. In March 2005, the district court denied petitioners' motion to dismiss the case and directed the magistrate judge to oversee a "limited" and "staged" discovery process. *Gallus v. American Express Fin. Corp.*, 370 F. Supp. 2d 862, 867 (D. Minn. 2005); *see* Pet. App. 26a n.5 (noting that the magistrate judge permitted respondents to

take discovery regarding only 2 of the 11 funds at issue).

In July 2006, the district court further limited discovery to the one-year period preceding the filing of the suit. *See* Pet. App. 42a-45a. The court interpreted § 36(b)(3)'s prohibition on damages "for any period *prior to* one year before the action was instituted," 15 U.S.C. § 80a-35(b)(3) (emphasis added), to bar recovery of damages for any period *after* the action was instituted. *See* Pet. App. 43a-44a. It accordingly held that petitioners need not respond to discovery requests "related to post-Complaint damages." *Id.* at 43a.

In July 2007, following completion of the limited first stage of discovery, the district court granted petitioners' motion for summary judgment and dismissed the action. *See id.* at 40a-41a. The court applied a standard it ascribed to the Second Circuit's decision in *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982). It required respondents to present evidence sufficient for a trier of fact to conclude that petitioners charged the Funds "'a fee that is *so disproportionately large* that it bears *no reasonable relationship* to the services rendered and *could not have been* the product of arm's-length bargaining.'" Pet. App. 29a (quoting *Gartenberg*, 694 F.2d at 928) (emphases added). In explaining its analysis, the court discussed a list of six factors drawn from the *Gartenberg* opinion. For each one, it concluded that the evidence did not show that petitioners' fees "could not have been" agreed to in an arm's-length negotiation. *See id.* at 29a-39a.

The district court acknowledged that, in approving petitioners' fees, the Funds' board placed little or no weight on the lower fees that petitioners charged

their independent clients. The board instead compared the fees paid by the Funds to fees paid by other similar mutual funds. *See id.* at 34a-36a; *see also id.* at 23a ("[T]he Board aspired to negotiate fees for the Funds that were at the median level of fees charged to comparable funds in the industry."). The court held that the board's failure to consider the lower fees paid by independent clients did not matter. Relying solely on a report, which petitioners created and which purported to show that the services provided to the Funds and the independent clients were different, the court stated that respondents had not "demonstrated" that services were comparable. *Id.* at 35a. The court also cited a statement from *Gartenberg* that the services provided to the money-market fund in that case were more extensive than the services that that adviser provided to its pension-fund clients. *See id.* at 34a-35a (citing *Gartenberg*, 694 F.2d at 930 n.3). Finally, the court adopted an Illinois district court's conclusion that, even assuming that the services provided to the two types of clients are "'indistinguishable,'" there is no violation of § 36(b) because "'the amounts paid by different parties establish a range of prices that investors were willing to pay.'" *Id.* at 35a (quoting *Jones v. Harris Assocs. L.P.*, No. 04-C-8305, 2007 WL 627640, at *8 (N.D. Ill. Feb. 27, 2007), *aff'd*, 527 F.3d 627 (7th Cir. 2008), *cert. granted*, No. 08-586 (argued Nov. 2, 2009)).

b. The Eighth Circuit reversed the district court's judgment and remanded the case for further proceedings. *See* Pet. App. 19a. It held that the district court "construed too narrowly the extent of the defendants' duty under § 36(b) and gave insufficient weight to contested issues of material fact." *Id.* at 2a.

The Eighth Circuit considered the *Gartenberg* decision to be "the starting point" for analyzing a fund adviser's fiduciary duty. *Id.* at 9a. In *Gartenberg*, the court explained, the Second Circuit "held that the relevant test for a fee is whether it 'represents a charge within the range of what would have been negotiated at arm's-length in light of all the surrounding circumstances'" and provided "a number of non-exclusive factors that were germane to the analysis." *Id.* (quoting *Gartenberg*, 694 F.2d at 928). Although the Eighth Circuit found that framework "useful," it cautioned that *Gartenberg* "should not be construed to create a safe harbor of exorbitance" under which a fee passes muster so long as it is within the range of fees paid by other similar mutual funds. *Id.* at 12a-13a.

To avoid "eviscerat[ing] § 36(b)" in that manner, the court of appeals reasoned, courts must consider "a comparison between the fees charged to [the adviser]'s institutional clients and its mutual fund clients." *Id.* at 13a, 14a. On that issue, the Eighth Circuit found that the district court erred in relying on dicta from *Gartenberg* and in ignoring "conflicting expert testimony on the accuracy and veracity" of petitioners' assertions that the services differ. *Id.* at 14a-15a. The lower court instead "should have explored the disputed issues of material fact" concerning the comparability of the services provided to the Funds and the independent clients. *Id.* at 15a. The Eighth Circuit further explained that "the argument for comparing mutual fund advisory fees with the fees charged to institutional accounts is particularly strong in this case because the investment advice may have been essentially the same for both accounts." *Id.* at 14a.

In addition, the Eighth Circuit concluded that charging a fee that is excessive – whether in comparison to fees paid by other mutual funds or to those paid by independent clients – "is not the only way" in which an adviser can breach its fiduciary duty. *Id.* at 12a. The court of appeals agreed with the Seventh Circuit's decision in *Jones v. Harris Associates L.P.*, 527 F.3d 627 (7th Cir. 2008), *cert. granted*, No. 08-586 (argued Nov. 2, 2009), that "the plain language of § 36(b) . . . impose[s] on advisers a duty to be honest and transparent throughout the negotiation process." Pet. App. 12a. The court explained that "*Jones* highlights a flaw in the way many courts have applied *Gartenberg*," *id.* – that is, the courts have focused solely on the size of the adviser's fee, without also considering whether the adviser complied with its fiduciary obligations of full disclosure and good-faith negotiation. Thus, "the proper approach to § 36(b) is one that looks to both the adviser's conduct during negotiation and the end result," and "[u]nscrupulous behavior with respect to either can constitute a breach of fiduciary duty." *Id.* at 13a. Applying that approach to this case, the Eighth Circuit held that the district court also "should have determined whether [petitioners] purposefully omitted, disguised, or obfuscated information that [they] presented to the Board about the fee discrepancy between" the Funds and the independent clients, as "[t]he record indicates that there are material questions of fact on this issue." *Id.* at 15a.

Finally, the Eighth Circuit held that the district court erred in restricting the damages period to the one-year period before the filing of the complaint. *See id.* at 16a-17a. The court of appeals explained that "a straightforward reading of" § 36(b)(3)'s

language "yields only a retrospective limitation." *Id.* Therefore, "where the plaintiffs have continued to suffer damage during the litigation, both the language of the statute and the interests of judicial economy suggest that redress should be available in a single action." *Id.* at 17a.

c. Petitioners did not file a petition for rehearing and instead filed this petition for a writ of certiorari. On remand in the district court, petitioners have moved for a stay of proceedings pending this Court's decision in *Jones*. Respondents have not opposed that motion.

DISCUSSION

Petitioners present two questions for this Court's review. The first involves the meaning of § 36(b)'s "fiduciary duty," and the second concerns the proper interpretation of the damages period in § 36(b)(3). Pet. i. Petitioners assert that this Court should hold the petition and dispose of it in light of *Jones* or, alternatively, grant the petition limited to the second question presented. Pet. 25.

With respect to the first question presented, respondents agree that the petition should be held for *Jones*. If the Court there reverses or vacates the judgment, however, the petition should be denied. The lower courts here can implement this Court's guidance without further action by the Court.

Regardless of the outcome in *Jones*, the Court should deny certiorari with respect to the second question presented. The interpretation of § 36(b)(3)'s damages period is not before this Court in *Jones*, and petitioners do not assert that this Court's decision in that case could affect the Eighth Circuit's resolution of that issue. Further, there is no division of authority warranting this Court's review on the second

question presented; the Eighth Circuit's construction of § 36(b)(3) is clearly correct; and review would be unwarranted at this interlocutory stage in any event. Therefore, the Court should deny review on the second question regardless of how it proceeds on the first question.

I. IF THE COURT REVERSES OR VACATES IN *JONES v. HARRIS ASSOCIATES L.P.*, No. 08-586, THEN IT SHOULD DENY THE PETITION

If this Court reverses or vacates the Seventh Circuit's judgment in *Jones*, then it should deny the petition. Petitioners' criticisms of the Eighth Circuit's decision are incorrect.

A. The Lower Courts Can Implement This Court's Decision In *Jones* Without Further Action By This Court

The Eighth Circuit remanded this case to the district court for further proceedings. *See* Pet. App. 19a. In conducting the proceedings on remand, the district court can take into account the guidance provided by this Court in *Jones*. To the extent either party is dissatisfied with the district court's application of *Jones*, review will be available in the Eighth Circuit. Accordingly, no further action by this Court is necessary to ensure that the lower courts consider the effect of *Jones* on this case.[1]

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[1] The district court would not be bound to follow anything in the Eighth Circuit's opinion in this case that is inconsistent with this Court's decision in *Jones*. *See, e.g.*, *United States v. Behler*, 100 F.3d 632, 639 n.2 (8th Cir. 1996) ("The 'law of the case' doctrine does not apply when an intervening decision from a higher tribunal renders a prior determination erroneous.") (internal quotation marks omitted); *Morris v. American Nat'l Can Corp.*, 988 F.2d 50, 52 (8th Cir. 1993) ("[T]he law of the case does not apply when an intervening decision from a superior

B. The Court Of Appeals' Decision Is Correct

In all events, the decision below is correct.

1. Section 36(b)'s fiduciary duty requires full disclosure and fairness

The Eighth Circuit faithfully interpreted and applied § 36(b)'s text. Section 36(b) imposes on investment advisers "a fiduciary duty with respect to the receipt of compensation for services." 15 U.S.C. § 80a-35(b). When a fiduciary negotiates with one to whom it owes a fiduciary duty regarding a transaction in which the fiduciary has an interest – for example, regarding the fiduciary's compensation – the fiduciary must comply with two fundamental requirements. First, the fiduciary must provide full and accurate disclosure of all material facts relating to the transaction. Second, the transaction must be fair to the beneficiary. *See, e.g., Restatement (Second) of Trusts* § 2 cmt. b (1959) ("If the fiduciary enters into a transaction with the other and fails to make a full disclosure of all circumstances known to him affecting the transaction or if the transaction is unfair to the other, the transaction can be set aside by the other."); *Pepper v. Litton*, 308 U.S. 295, 306 (1939) (fiduciary must act in "good faith" and transaction must be "inherent[ly] fair[] from the viewpoint of the" beneficiary); *see also Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, J.).

In employing the term "fiduciary duty" in § 36(b), Congress is presumed to have intended to incorporate

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tribunal clearly demonstrates the law of the case is wrong."); 18B Charles Alan Wright et al., *Federal Practice and Procedure* § 4478.3, at 746 n.24 (2d ed. 2002) (collecting cases holding that a district court can depart from the court of appeals' mandate to follow intervening, controlling authority).

those familiar common-law principles.[2] The Investment Company Institute ("ICI"), which in 1969 represented companies controlling 97.8 percent of the industry's net assets,[3] recognized as much during consideration of the 1970 Amendments. The ICI told Congress that, in applying § 36(b), "the court will look to the general law of fiduciary relationships which involve the negotiating of fees by a fiduciary." 1969 Hearings at 441. In a memorandum submitted to Congress, the SEC similarly recognized that § 36(b) "is in accordance with the traditional function of the courts to enforce fiduciary duties." *Id.* at 189. The SEC also specifically noted that investment advisers are "like other corporate fiduciaries," including "directors of corporations," and explained that the same rigorous standard of fairness that applies to a director's or controlling shareholder's dealings with her corporation would apply to an investment adviser's dealings with its captive funds. *Id.* at 189-90; *see id.* at 190 (citing *Pepper* as articulating the appropriate standard).[4]

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[2] *See, e.g., Neder v. United States*, 527 U.S. 1, 21 (1999) (articulating the "well-established rule of construction that '[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms'") (quoting *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322 (1992)) (alterations in original).

[3] *See Mutual Fund Amendments (Part 1): Hearings Before the Subcomm. on Commerce and Finance of the H. Comm. on Interstate and Foreign Commerce*, 91st Cong. 186 (1969) ("1969 Hearings").

[4] *See also* 1969 Hearings at 190 & n.4 (SEC Memorandum) (explaining that, under the bill that became § 36(b), "a breach of fiduciary duty involving management fees would occur when

Thus, the Eighth Circuit correctly held that "the proper approach to § 36(b) is one that looks to both the adviser's conduct during negotiation and the end result." Pet. App. 13a. "Unscrupulous behavior with respect to either can constitute a breach of fiduciary duty." *Id.* On this record, the court of appeals found "contested issues of material fact," *id.* at 2a, regarding both aspects of the § 36(b) fiduciary duty. Regarding petitioners' conduct during negotiation of their compensation, the court determined that "material questions of fact" exist as to whether petitioners "purposefully omitted, disguised, or obfuscated information that it presented to the Board about the fee discrepancy between different types of clients." *Id.* at 15a.

Regarding the fairness of the "end result" of the negotiation, the Eighth Circuit concluded that there are "disputed issues of material fact" concerning whether petitioners breached their fiduciary duty by charging the Funds materially higher fees than they charged their independent clients for "essentially the same" services. *Id.* at 14a, 15a. The Eighth Circuit directed the district court to determine on remand whether any purported differences in services provided to the independent clients justified the disparity between the fees they pay and the fees paid by the Funds. *See id.* Notably, petitioners now acknowledge that fees paid by independent clients are

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compensation to the adviser for his services is excessive in view of the services rendered – where the fund pays what is an unfair fee under the circumstances" and that "neither disclosure nor shareholder assent can convert a dishonest transaction into a fair one") (internal quotation marks omitted); *id.* at 441 (ICI Letter) ("[An adviser] may not overreach in the amount of his fee even though the other party to the transaction, in full possession of all the facts, does not believe the fee is excessive.").

relevant when the services provided are comparable. *See* Pet. 21. Both parties in *Jones*, as well as the United States, agree. *See* No. 08-586 Oral Arg. Tr. 38-39 (argument of respondent's counsel) (stating that there is "no problem" with making a comparison to institutional investors a "relevant consideration"); *id.* at 39; No. 08-586 Pet. Br. 30-31; No. 08-586 Resp. Br. 38; No. 08-586 U.S. Br. 29-32.[5]

2. Petitioners' criticisms of the decision below lack merit

a. Petitioners pose (at 20-21) a series of objections to the Eighth Circuit's recognition that an adviser's fiduciary duty requires the adviser to be "honest and transparent throughout the negotiation process." Pet. App. 12a. Each is unavailing.

Petitioners claim that the fair-negotiation requirement conflicts with § 36(b)'s language creating a fiduciary duty "with respect to the receipt of compensation." 15 U.S.C. § 80a-35(b). But petitioners fail to explain why an adviser's provision of information about and negotiation regarding *its compensation* lie beyond the scope of that fiduciary duty. Nor could they. As this Court has concluded, the phrase "with respect to" quite broadly encompasses the subjects in issue. *See Riegel v. Medtronic, Inc.*, 128 S. Ct.

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[5] Petitioners repeatedly claim that the district court found on the basis of "undisputed" evidence that the services provided to the Funds and to the independent clients were different. Pet. 12, 19. But that is incorrect. As the Eighth Circuit held, there are "*disputed* issues of material fact concerning the similarities and differences between" the services provided to the Funds and the independent clients, and respondents' argument that the services are in fact comparable "is particularly strong in this case because the investment advice may have been essentially the same for both accounts." Pet. App. 14a-15a (emphasis added).

999, 1010 (2008) (rejecting argument that a statute preempting requirements "with respect to a device" was inapplicable unless the requirement in question applied "*only* to the relevant device, or only to medical devices and not to all products and all actions in general").

Nor is there any basis for petitioners' suggestion (at 20) that the Eighth Circuit's standard somehow conflicts with § 36(b)(1)'s language providing that shareholders need not "allege or prove that any defendant engaged in personal misconduct." 15 U.S.C. § 80a-35(b)(1). To the extent petitioners contend that, because the statute says "that proof of 'misconduct' is *not* required" (Pet. 20), misconduct is not actionable under § 36(b), their position is nonsensical. Section 36(b) creates a cause of action to remedy all adviser "misconduct" that constitutes a breach of fiduciary duty with respect to the receipt of compensation. The point of the statutory language petitioners cite is to relieve shareholders of the burden of proving that a particular individual committed "*personal* misconduct," 15 U.S.C. § 80a-35(b)(1) (emphasis added) – something that the SEC must prove under ICA § 36(a) to obtain an order barring a person from working for an investment adviser or underwriter, *see id.* § 80a-35(a) (authorizing SEC action against "a person" engaged in "a breach of fiduciary duty involving personal misconduct").

Petitioners also seek (at 20) support in Congress's decision to limit recovery under § 36(b) to "actual damages." 15 U.S.C. § 80a-35(b)(3). But petitioners confuse the content of the fiduciary duty with the remedy for violation of that duty. Section 36(b)'s restriction on the damages recoverable from an adviser that has breached its fiduciary duty creates no

limitation on the duty itself. A shareholder need not have suffered "actual damages" to have a valid cause of action under § 36(b). Indeed, § 36(b)(3) expressly contemplates that plaintiffs may seek "other relief," such as an injunction or rescission of the adviser's contract with the fund. *Id.*; *see id.* § 80a-46(b) (rescission). In addition, where a shareholder shows that the adviser's fee would have been different if the adviser had provided full and accurate disclosure and negotiated in good faith, then she has established actual damages recoverable under § 36(b).

Petitioners express concern (at 20-21) that the Eighth Circuit's standard will "turn judges into 'super-director' second-guessers of business decisions made by independent boards." That argument has no merit. The Eighth Circuit's standard ensures that fund boards in fact function independently in approving adviser compensation (and that they receive complete and accurate information regarding that compensation). That is precisely the role Congress envisioned for courts.[6] Indeed, during consideration of the 1970 Amendments, the ICI represented to Congress that "[t]he court would undoubtedly consider whether the investment adviser has acted fairly and diligently in supplying information to the Board of Directors of the investment company" and that "the

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[6] *See* S. Rep. No. 91-184, at 6 (§ 36(b) "authorize[s] *the court* to determine whether the investment adviser has committed a breach of fiduciary duty in determining or receiving the fee," and "the ultimate responsibility for the decision in determining whether the fiduciary duty has been breached rests with *the court*") (emphases added); *id.* at 15-16 ("the ultimate test, *even if the compensation or payments are approved by the directors* and stockholders, . . . will be whether the investment adviser has fulfilled his fiduciary duty to the mutual fund shareholders in determining the fee") (emphasis added).

court would focus on the substance and quality of the negotiations" between the adviser and the fund board "in determining whether the adviser had breached his fiduciary obligations." 1969 Hearings at 441.

In touting the role of fund boards in § 36(b) actions, petitioners cite (at 21) *Burks*, which held that state law can authorize disinterested fund directors to terminate a derivative suit under the ICA against other fund directors. *See* 441 U.S. at 473, 486. But they ignore this Court's subsequent decision in *Daily Income Fund*, which reached the opposite conclusion under § 36(b). In *Daily Income Fund*, the Court held that fund boards lack the power to control derivative litigation under § 36(b) because Congress intended shareholder suits under that provision "to act as [an] independent check[] on excessive fees." 464 U.S. at 541.

b. Although conceding that the fees charged to independent clients "may be relevant," petitioners maintain (at 21) that the district court correctly rejected the comparison to those fees as irrelevant. That is incorrect. As the court of appeals found, the district court erroneously ignored "the disputed issues of material fact concerning the similarities and differences between mutual funds and institutional accounts," particularly because "the investment advice may have been essentially the same for both" types of clients. Pet. App. 14a-15a. Indeed, in an internal email, employees of petitioners admitted that petitioners' explanation for the disparity in fees charged to the two types of clients "may or may not be convincing." *Id.* at 6a (internal quotation marks omitted). Regardless, that fact-bound dispute warrants no further review by this Court.

II. REVIEW OF THE EIGHTH CIRCUIT'S CORRECT INTERPRETATION OF § 36(b)'S DAMAGES PERIOD IS UNWARRANTED IN ANY EVENT

Petitioners assert (at 15, 24-25) that, if this Court does not grant, vacate, and remand in light of *Jones*, it should grant the petition to consider whether the Eighth Circuit properly defined the damages period. But petitioners make no serious effort to satisfy any of this Court's criteria for granting certiorari. Further review of this issue is unwarranted.

A. The Eighth Circuit's Decision Conflicts With No Decision Of This Court Or Any Other Court Of Appeals

Petitioners suggest (at 15) that "courts" have divided over the damages period in § 36(b) litigation. But petitioners identify no decision of this Court or another court of appeals reaching a conclusion contrary to the Eighth Circuit's. They cite (at 23) a phrase from a footnote in the background section of the opinion in *Daily Income Fund*, as well as similar isolated language from a Seventh Circuit opinion.[7] But the damages period was not at issue in either of those cases. Therefore, the brief dicta in those opinions bind no court and create no division of authority that might warrant this Court's review. *See, e.g.*, *Central Virginia Community College v. Katz*, 546 U.S. 356, 363 (2006) ("[W]e are not bound to follow

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[7] The entirety of the discussion of the damages period in those cases was limited to the phrases petitioners quote (at 23). *See Daily Income Fund*, 464 U.S. at 526 n.2 ("recovery is limited to actual damages for a period of one year prior to suit"); *Green v. Nuveen Advisory Corp.*, 295 F.3d 738, 743 (7th Cir. 2002) ("damages are recoverable only for the one-year period before the filing of the action").

our dicta in a prior case in which the point now at issue was not fully debated."); *Jama v. Immigration & Customs Enforcement*, 543 U.S. 335, 351 n.12 (2005) ("Dictum settles nothing, even in the court that utters it."); *United States v. Elliott*, 467 F.3d 688, 690 (7th Cir. 2006) ("dicta are not binding" because "judicial comments lacking the benefit of an adversarial presentation are more likely to be uninformed").

B. The Eighth Circuit's Interpretation Of § 36(b)(3) Is Correct

The Eighth Circuit's statutory interpretation is plainly correct. Section 36(b)(3) provides that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted." 15 U.S.C. § 80a-35(b)(3). That provision places no limit on recovery of damages *after* the initiation of the litigation. Therefore, as the Eighth Circuit properly held, "a straightforward reading of the damage limitation yields only a retrospective limitation" on recoverable damages. Pet. App. 16a-17a.

Petitioners claim, however, that § 36(b)(3)'s restriction on damages "for any period *prior to* one year before the action was instituted," 15 U.S.C. § 80a-35(b)(3) (emphasis added), also limits recovery of damages incurred *after* the action was instituted. But the statutory text simply contains no such limitation. *See* Pet. App. 16a ("The plain language of the statute . . . does not support [petitioners'] interpretation."). Petitioners' own authority acknowledges this much. *See In re Franklin Mut. Funds Fee Litig.*, 478 F. Supp. 2d 677, 685 (D.N.J. 2007) ("§ 36(b)(3) does not explicitly place an end date on when a plaintiff may recover damages under § 36(b)").

Retreating from the statutory text, petitioners argue (at 23) that their a-textual approach to the statute "makes sense" because, under the ICA, an adviser's compensation must be approved annually. That is a non sequitur. That the ICA provides for annual review of advisory fees does not suggest that Congress intended to require a separate civil action for each year in which the adviser breaches its fiduciary duty. Indeed, the best evidence of Congress's intent is § 36(b)(3)'s text. In the statute, Congress barred recovery of damages "for any period *prior to* one year before the action was instituted," 15 U.S.C. § 80a-35(b)(3) (emphasis added), but said nothing about recovery of damages for any period *after* the commencement of the case. The only reasonable inference is that Congress did not intend to require shareholders to bring § 36(b) actions piecemeal.

Consideration of the background rule against which Congress legislated removes all doubt on that score. The general rule is that, "if an injury is permanent or continuing in character, the plaintiff may recover all damages accruing after the commencement of the suit." 22 Am. Jur. 2d *Damages* § 484 (2003); *accord Dumond v. Massachusetts Fin. Servs. Co.*, No. 04-11458-GAO, 2007 WL 602589, at *2 (D. Mass. Feb. 22, 2007) ("In civil actions generally, absent some express limitation, proof of damages is not restricted to the time before the filing of the complaint, and damages caused by a defendant's liability-producing conduct ordinarily may be proved through the time of trial and judgment."). If Congress had intended to vary that rule and bar damages after the filing of the complaint, it could have said so. That it did not further undermines petitioners' attempt to rewrite the statute.

Equally unavailing is petitioner's suggestion (at 24) that applying § 36(b)(3) as written would be unworkable. Where an adviser has breached its fiduciary duty in multiple years, then the pleadings, discovery, and the presentation of evidence can include events with respect to each of those years. Petitioners identify nothing unique about § 36(b) litigation that requires claims to be handled in installments.[8]

Indeed, petitioners' theory *reduces* judicial economy by requiring related events to be adjudicated in multiple actions. As the Eighth Circuit explained, "where the plaintiffs have continued to suffer damage during the litigation, both the language of the statute and the interests of judicial economy suggest that redress should be available in a single action." Pet. App. 17a; *see also Independent Fed'n of Flight Attendants v. Zipes*, 491 U.S. 754, 764 (1989) ("piecemeal litigation" is "strongly disfavored"). Congress sensibly rejected petitioners' proposal for serial lawsuits covering successive damages periods.

C. The Eighth Circuit's Decision Is Interlocutory

In any event, review is unwarranted because the decision below is interlocutory. Even if this Court were to hold that the applicable damages period ends at the filing of the complaint, that would not resolve the litigation. Further proceedings will take place regardless, and it would make no sense to engage in piecemeal review of the damages period. The issue could be reviewed, if necessary, after a final judgment is entered. *See Brotherhood of Locomotive Fire-*

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[8] As for petitioners' fear (at 23-24) that "discovery could never close" unless post-complaint damages are barred, district courts have ample tools to manage litigation efficiently. *See, e.g.*, Fed. R. Civ. P. 16.

men v. Bangor & Aroostook R.R., 389 U.S. 327, 328 (1967) (per curiam) ("[B]ecause the Court of Appeals remanded the case, it is not yet ripe for review by this Court.") (citing *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 257-58 (1916) ("[E]xcept in extraordinary cases, the writ is not issued until final decree.")).

CONCLUSION

With respect to the first question presented, the petition for a writ of certiorari should be held pending this Court's decision in *Jones*. If the Court reverses or vacates in *Jones*, the petition should be denied. Regardless of the disposition of the first question, the Court should deny the petition as to the second question presented.

Respectfully submitted,

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REPLY BRIEF

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IN THE

Supreme Court of the United States

AMERIPRISE FINANCIAL, INC., *et al.*,
Petitioners,

v.

JOHN E. GALLUS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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TABLE OF CONTENTS

		Page
Introduction		1
Argument		4
I.	The Court Should Grant the Petition and Vacate the Eighth Circuit's Decision After Deciding *Jones*	4
II.	The Eighth Circuit's Decision Is Inconsistent With the Text and Structure of the Investment Company Act	5
	1. The Eighth Circuit Disregarded the Deference Due Board Deliberations Under § 36(b)(2)	5
	2. Ostensible "Process" Flaws Do Not Warrant § 36(b) Liability Absent a Material Effect on Fees	8
	3. Congress Did Not Import Trust Law into § 36(b)	9
	4. Comparison to Institutional Accounts Is Not Dispositive	10
III.	If the Court Does Not Hold the Petition, It Should Grant Certiorari on the One-Year Limitation on Damages	12

TABLE OF AUTHORITIES

Page

CASES

Bellikoff v. *Eaton Vance Corp.*, 481 F.3d 110 (2d Cir. 2007) 8

Burks v. *Lasker*, 441 U.S. 471 (1979) 2, 3, 6

Daily Income Fund, Inc. v. *Fox*, 464 U.S. 523 (1984) 3, 6, 12

Gartenberg v. *Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982) 4, 7, 10

Green v. *Fund Asset Mgmt., L.P.*, 286 F.3d 682 (3d Cir. 2002) 8

Green v. *Nuveen Advisory Corp.*, 295 F.3d 738 (7th Cir. 2002) 8

Kamen v. *Kemper Fin. Servs.*, 500 U.S. 90 (1991) 6

Krantz v. *Prudential Invs. Fund Mgmt. LLC*, 305 F.3d 140 (3d Cir. 2002) 9

Migdal v. *Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321 (4th Cir. 2001) 8

Pepper v. *Litton*, 308 U.S. 295 (1939) 7

Saxe v. *Brady*, 40 Del. Ch. 474 (1962) 10

SEC v. *Chenery Corp.*, 318 U.S. 80 (1943) 9

STATUTES

15 U.S.C. § 80a-2(a)(19) 6

15 U.S.C. § 80a-10(a) 6

15 U.S.C. § 80a-15(c) 3, 6

15 U.S.C. § 80a-16(b) 10

15 U.S.C. § 80a-35(a) 9

TABLE OF AUTHORITIES—Continued

Page

15 U.S.C. § 80a-35(b) ..... *passim*
15 U.S.C. § 80a-41 9
15 U.S.C. § 80b-9 9
17 C.F.R. § 240-14a-101 ..... 10, 11
17 C.F.R. § 270.0-1(a)(7)(ii) 10
Pub. L. No. 91-547, 84 Stat. 1413 6

MISCELLANEOUS

H.R. Rep. No. 1382, 91st Cong., 2d Sess. (1970) 7
S. Rep. No. 184, 91st Cong., 1st Sess. (1969) 3

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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REPLY BRIEF FOR PETITIONERS

INTRODUCTION

Respondents agree the petition should be held pending disposition of *Jones* v. *Harris Associates L.P.*, No. 08-586. Opp. 1, 10. But they illogically assert that this Court should not reverse the Eighth Circuit's decision unless it affirms the Seventh Circuit's judgment in *Jones*. *Id.* at 11. That would leave the Eighth Circuit's interpretation of §36(b)'s "fiduciary duty," 15 U.S.C. §80a-35(b), undisturbed even if it differs from this Court's ruling in *Jones*. The Court should instead vacate the Eighth Cir-

cuit's decision and remand for proceedings consistent with *Jones*.

The Eighth Circuit's decision is not faithful to the text of §36(b) or the structure of the Investment Company Act (ICA). Its holding that a flaw in negotiations justifies §36(b) liability without regard to impact on fees disregards the textual limitation of an adviser's fiduciary duty to the "receipt of compensation" and the explicit requirement that a plaintiff prove "actual damages." And the panel's conclusion that the district court's job is to determine what investment advisory services are "worth," Pet. App. 14a, usurps Congress's delegation to independent directors of the responsibility to negotiate fees. Those errors compound the flawed logic of the *Jones* petitioners, who contended that courts should always decide if fees are "fair and reasonable." *Jones* Pet. Br. 17, 38. Since any plaintiff could claim some negotiating defect in hindsight, or that fees were just "unfair[ly]" high, the Eighth Circuit's rule threatens to consign 8,000 mutual funds to trial for review of both their fees and the process by which they were set—all on the say-so of a single stockholder.

The Eighth Circuit also erred by applying its standard to require district courts to give primacy to a comparison between mutual fund advisory fees and charges to institutional accounts. Pet. App. 14a-15a. That imposes a mandatory obligation on judges to make a comparison the SEC's regulations only make discretionary for independent directors.

Respondents misconstrue §36(b)'s role in the ICA's overall scheme. Congress did not authorize judicial second-guessing of fee negotiations out of concern that fund directors were structurally incapable of negotiating fair fees. Opp. 17-18. It did precisely the opposite and assigned to directors the primary responsibility to negotiate and approve fees. See *Burks* v. *Lasker*, 441 U.S. 471,

485 (1979) ("[I]t would have been paradoxical for Congress to have been willing to rely largely upon 'watchdogs' to protect shareholder interests and yet, where the 'watchdogs' have done precisely that, require that they be totally muzzled."). Nor did Congress enact §36(b) to "combat the continuing problem of excessive investment-adviser fees." Opp. 3. Congress specifically refused to make any finding about the level of fees when it adopted the 1970 Amendments to the ICA.[1] Those amendments instead focused upon enhancing the "cornerstone" role of mutual fund directors by "strengthen[ing]" their independence, *Burks*, 441 U.S. at 482, and affording them the tools they needed to do their job. See, *e.g.*, 15 U.S.C. §80a-15(c) (obliging advisers to disclose all information "as may reasonably be necessary" to evaluate advisory contract terms). Section 36(b) was added as one element among a comprehensive set of measures that operate as "independent checks" on fees. *Daily Income Fund, Inc.* v. *Fox*, 464 U.S. 523, 541 (1984). But an "independent check" is not a *de novo* review of a decision the statute otherwise entrusts to directors. It is a safeguard against obvious overreaching.

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[1] See S. Rep. No. 184, 91st Cong., 1st Sess. 5 (1969) (provisions "should not be taken as reflecting any finding by the committee that the present industry level of management fees or that the fee of any particular adviser is too high").

ARGUMENT

I. THE COURT SHOULD GRANT THE PETITION AND VACATE THE EIGHTH CIRCUIT'S DECISION AFTER DECIDING *JONES*

Respondents agree that holding this petition until resolution of *Jones* is appropriate. Opp. 1, 10. But they contend the petition should be denied if this Court reverses or vacates the Seventh Circuit's judgment in *Jones*. *Id.* at 11. That invites chaos in the lower federal courts. Unless this Court's *Jones* opinion adopts the reasoning of the decision below in its entirety, this Court should follow its usual course of granting the petition, vacating the decision below, and remanding for further proceedings in light of its decision in *Jones*. That will allow the courts below to apply whatever test this Court articulates. Denying the petition and leaving the Eighth Circuit's decision undisturbed invites the lower courts to speculate whether any aspect of the decision below retains vitality despite what this Court says in *Jones*.

Respondents' proposal that the Court deny the petition if the Court reverses in *Jones* also ignores the course of proceedings in *Jones*. No party in *Jones* endorsed the Seventh Circuit's reasoning. Instead, all parties (and the United States) urged the Court to adopt the standard articulated in *Gartenberg* v. *Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982)—which the district court itself applied.[2] If this Court adopts that test, it may choose to apply it in *Jones* to provide needed guidance to the lower courts.[3] That too would require the Eighth Circuit's decision to be vacated.

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[2] See, *e.g.*, *Jones* Resp. Br. 23-25; *Jones* Br. of U.S. 11-12; *Jones* Pet. App. 16a-17a, 31a.

[3] See *Jones* Oral Arg. Tr. 43-45.

II. THE EIGHTH CIRCUIT'S DECISION IS INCONSISTENT WITH THE TEXT AND STRUCTURE OF THE INVESTMENT COMPANY ACT

The Eighth Circuit's conclusion that §36(b) requires a district court to re-enact independent directors' negotiations and make its own determination of what advisory services are "worth," Pet. App. 14a, is inconsistent with the statute's text and structure. The existence of a "fiduciary duty with respect to the receipt of compensation" does not authorize *de novo* judicial review of fees for "fairness." The statutory delegation of responsibility to independent directors to approve fees does not countenance judicial micromanagement of negotiations in hindsight. And nothing in the ICA mandates a comparison to fees charged other clients.

1. *The Eighth Circuit Disregarded the Deference Due Board Deliberations Under §36(b)(2)*

The Eighth Circuit recognized that "§36(b) does not allow a court 'to substitute its business judgment for that of a mutual fund's board of directors in the area of management of fees.'" Pet. App. 15a (quoting *Gartenberg*, 694 F.2d at 928). But then it did precisely that. It held—on the basis of expert reports that disagreed with Ameriprise's *method* of presenting information about institutional account charges to the board—that the directors may not have properly considered institutional fees in making their judgment. Pet. App. 14a-15a. The panel explained that the "purpose of an inquiry" is "to determine what the investment advice is worth." Pet. App. 14a. The Appeals Court thus set aside the deliberations of an experienced board comprised of experts in finance, economics, and law.

That ignores the deference that §36(b) and the ICA accord to board decisions and instead appoints judges the ultimate arbiters of what services are "worth." The 1970

Amendments to the ICA (the "1970 Amendments"), Pub. L. No. 91-547, 84 Stat. 1413 (1970), did not enact such a judicial rate-setting scheme. Rather, the 1970 Amendments aimed to "strengthen" the independence of directors and to improve their negotiating leverage by arming them with all information "necessary" to evaluate fees. *Burks*, 441 U.S at 482; 15 U.S.C. §§80a-2(a)(19), 80a-10(a), 80a-15(c). Independent and equipped boards thus form "the cornerstone of the ICA's effort to control conflicts of interest within mutual funds." *Kamen* v. *Kemper Fin. Servs.*, 500 U.S. 90, 107 (1991) (quoting *Burks*, 441 U.S. at 482). "[The Act] was designed to place the unaffiliated directors in the role of 'independent watchdogs,' who would 'furnish an independent check upon the management' of investment companies." *Burks*, 441 U.S. at 484 (citations omitted). The remedy authorized by §36(b) was intended "as [an] independent check[] on excessive fees." *Daily Income Fund*, 464 U.S. at 541. But an "independent check" cannot be a *de novo* review of the board's process and decision.

a. It would be "paradoxical" for Congress to place boards in a "cornerstone" role if it intended for courts to re-do their decisions. *Burks*, 441 U.S. at 485. Respondents' suggestion that boards are incapacitated by the industry's structure—in which mutual funds stay with their organizing adviser—is untenable. Congress rejected that "structural bias" argument by assigning to boards the exclusive authority to negotiate fees. As this Court emphasized in *Burks*, "[a]ttention must be paid as well to what Congress did *not* do. Congress consciously chose to address the conflict-of-interest problem through the Act's independent-directors section." *Id.* at 483; see also *id.* at 484 ("Congress turned not to direct controls, but rather to stiffening the requirement of independence as the way to remedy the act's deficiencies." (citations omitted)). The ICA's structure is thus inconsistent with

the *de novo* review of fees and process the Eighth Circuit ordered and respondents espouse.

This case proves the point. The stockholder plaintiffs generally paid below-median fees for above-median performance, notwithstanding alleged negotiating "flaws." See Record Appendix of the Court of Appeals ("R.A.") 194-95, 242, 283. And the board negotiated contracts that adjusted fees if performance faltered. *Id.* at 180, 244-45. That cannot be squared with any reasonable conclusion of overreaching by the adviser.

b. The statutory text corroborates the conclusion against *de novo* judicial review the ICA's structure dictates. Section 36(b)(2) commands that courts "shall" give directors' approval the consideration it is due under all the circumstances. There would be no reason for that directive if judges must establish what advisory services were "worth" on their own. As the legislative history of §36(b)(2) makes clear, Congress proposed that courts ask "whether the deliberations of the directors were a matter of substance or a mere formality." H.R. Rep. No. 1382, 91st Cong., 2d Sess. 37 (1970). But that inquiry is not a license for *de novo* review. See *ibid.* ("[S]uch consideration would not be controlling in determining whether or not the fee encompassed a breach of fiduciary duty.").

Nor would the common-law understanding of the term "fiduciary duty" authorize judicial reassessment of fees for "fairness." In view of the corporate context in which Congress acted, reference to trust law is inapt. Under familiar principles of corporate fiduciary law—as modified by §36(b)(2)'s sliding-scale deference and §36(b)(1)'s reversal of the common law burden of proof—courts may upset board judgments only when a fee is "so disproportionate" that it "could not" have been fairly bargained. See *Pepper* v. *Litton*, 308 U.S. 295, 306-07 (1939) ("essence" of the test is the "earmark[] of an arm's length bargain"); *Gartenberg*, 694 F.2d at 928.

2. *Ostensible "Process" Flaws Do Not Warrant §36(b) Liability Absent a Material Effect on Fees*

Respondents defend the Eighth Circuit's holding that alleged "process flaws" can establish a §36(b) violation by invoking the law of trusts. Opp. 12. That wrongly assumes Congress imported trust law into §36(b), rather than corporate fiduciary principles that naturally fit into what is, after all, a corporate context. More important, it ignores the textual limitation of an adviser's "fiduciary duty" to the "receipt of compensation."

a. Respondents' explanation that "process flaws" inexorably relate to the "receipt of compensation" is unconvincing. Opp. 15. Permitting a claim predicated upon a "process" defect with an attenuated link to compensation mutates §36(b) from a check on "excessive fees" into a catch-all claim against investment advisers. But §36(b) is not a device to vindicate other wrongs; it is limited to claims for excessive fees.

The possibility of "process flaws" is what animates §36(b)(2)'s sliding scale of deference to boards. Judges may properly decrease their respect for board approval if negotiations are materially compromised. But it is precisely because that scale of deference exists to review whether board decisions were "substance or a mere formality" that "process flaws" alone do not justify liability. That has been the consistent conclusion of the lower federal courts. See, *e.g.*, *Green* v. *Fund Asset Mgmt., L.P.*, 286 F.3d 682, 685 (3d Cir. 2002)(§36(b) "was intended to provide a very specific, narrow federal remedy"); *Green* v. *Nuveen Advisory Corp.*, 295 F.3d 738, 743 (7th Cir. 2002) (same); *Bellikoff* v. *Eaton Vance Corp.*, 481 F.3d 110, 118 (2d Cir. 2007) ("[O]ne must allege excessive fees, rather than fees that might simply be described as 'improper.'"); *Migdal* v. *Rowe Price-Fleming Int'l*, 248 F.3d 321, 328-29 (4th Cir. 2001) ("Section 36(b) is limited to

cases where there was excessive compensation."); *Krantz* v. *Prudential Invs. Fund Mgmt. LLC*, 305 F.3d 140, 144 n.2 (3d Cir. 2002) (same). The SEC retains authority to address other violations. See, *e.g.*, 15 U.S.C. §§80a-35(a), 80a-41, 80b-9.

b. Respondents' suggestion that process flaws are independently actionable is unworkable. As this case demonstrates, a stockholder could compel a trial in any case by proposing that directors "should" have accorded different weight to information, and labeling the plaintiffs' own preferences "process" flaws. Here, the Eighth Circuit acknowledged that the board compared mutual fund fees with institutional account charges and recognized that the district court determined the comparison to be apples and oranges. Pet. App. 14a-15a. The Appeals Court nevertheless remanded for trial because a plaintiff's expert would have presented the comparison differently. *Ibid.* That approach would require a trial in all cases and leave district courts in the dark about how to approach their task.

3. *Congress Did Not Import Trust Law into §36(b)*

The root of respondents' defense of the Eighth Circuit opinion is the assertion that §36(b)'s "fiduciary duty with respect to the receipt of compensation" derives from principles of trust law. Opp. 12. But that is unenlightening *ipse dixit*. "[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry." *SEC* v. *Chenery Corp.*, 318 U.S. 80, 85-86 (1943). The implementation of "fiduciary duties" turns upon context. Respondents point to nothing in the statutory text or legislative history to suggest that Congress imported trust principles into the mutual fund context.

The closest analogy comes from corporate law, where shareholders are protected by a disinterested board they

elect.[4] Congress both incorporated and modified corporate principles—that ordinarily rejected second-guessing directors' business decisions, see, *e.g.*, *Saxe* v. *Brady*, 40 Del. Ch. 474, 486 (1962) (examining adviser compensation under corporate waste standard)—by authorizing "consideration" of board approval under §36(b)(2), and reversing the burden of proof under §36(b)(1).

The *Gartenberg* standard mirrors Congress's judgment. It espouses corporate principles that defer to directors' judgments, echoes *Pepper*'s "essential" test of a transaction that bears the "earmarks" of an "arm's length" bargain, and then turns that phrase upside down to reflect the statutory burden shift. The result—requiring a stockholder to show that a fee is "so disproportionately large" that it "could not have been the product of arm's-length bargaining," *Gartenberg*, 694 F.2d at 928—reflects the corporate context in which mutual funds operate. Trust law supplies no meaningful analog.

4. *Comparison to Institutional Accounts Is Not Dispositive*

The Eighth Circuit's decision gives primacy to the comparison between mutual fund advisory fees and charges to institutional accounts. Pet. App. 14a-15a. The Eighth Circuit thus makes judicial review of this comparison *mandatory* although the SEC's regulations only make consideration of the comparison by directors *discretionary*. SEC rules compel disclosure of fees an adviser charges to mutual funds with similar investment

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[4] The suggestion that mutual fund directors are typically selected by the investment adviser (see Opp. 2, 5) is false. SEC regulations require independent directors to be nominated by independent directors. See 17 C.F.R. §270.0-1(a)(7)(ii) (for exemptions to apply). Since "families" of funds typically employ a single board, the initial directors of any new fund will replicate the independent board already selected by independent directors.

objectives. See 17 C.F.R. §240-14a-101, item 22(c)(10). But the rules require disclosure of the "weight" directors place on a comparison to institutional accounts only *if* the directors contrast the charges; boards are not required to compare them. *Id.* at item 22(c)(11). The SEC thus does *not* consider the comparison with institutional accounts relevant in all circumstances. It follows that it cannot be dispositive.

To be sure, the comparison may be relevant on a case-by-case basis if a predicate for comparability is established. But that should be rare. Mutual fund portfolios require different management (to accommodate cash needs, to avoid taxable distributions, and to reflect portfolio size); require an infrastructure for the array of services offered to thousands of investors with individual accounts; operate under a comprehensive and highly regulated regime; and pay fees that reflect the entrepreneurial risk associated with the creation of funds that might not attract investors. See, *e.g.*, R.A. 257-72.

The directors here *did* consider the different services provided and fees charged to mutual funds and Ameriprise's institutional accounts. Ameriprise supplied them with a report that catalogued the fee and services differentials. Pet. App. 24a. The district court determined that respondents did not raise a genuine dispute that the services were comparable. *Id.* 35a. The factual dispute that provoked the Appeals Court's remand is only about how much *weight* the directors should have accorded to that consideration. The ICA and the SEC's regulations leave that judgment to directors.

III. If The Court Does Not Hold the Petition, It Should Grant Certiorari on the One-Year Limitation on Damages

Respondents dismiss the Appeals Court's refusal to limit damages to one year on the ground that the circuits are not split. Opp. 19. But the circuits are not split because nearly every district court to address the issue has applied the limitation. The logical interpretation of the statute is the one this Court suggested in *Daily Income Fund*, 464 U.S. at 526 n.2, and that district courts have consistently applied. The language "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted," § 36(b)(3), means that "recovery is limited to actual damages for a period of one year prior to suit," 464 U.S. at 526 n.2.

Respectfully submitted.

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